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FINANCIAL CONDITION OF FEDERALLY INSURED DEPOSITORY INSTITUTIONS

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

FIRST SESSION

ON

THE TESTIMONY OF TOP OFFICIALS OF THE FIVE REGULATORY AGENCIES TO REPORT ON THE FINANCIAL CONDITION OF THE INSTITUTIONS UNDER THEIR JURISDICTION

MAY 21, 1987

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FINANCIAL CONDITION OF FEDERALLY INSURED DEPOSITORY INSTITUTIONS

THURSDAY, MAY 21, 1987

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The committee met at 10 a.m., in room SD-538, Dirksen Senate Office Building, Senator William Proxmire (chairman of the committee) presiding.

Present: Senators Proxmire, Dixon, Sanford, Garn, D'Amato, Hecht, Bond, Chafee, and Karnes.

OPENING STATEMENT OF CHAIRMAN PROXMIRE

The CHAIRMAN. The committee will come to order.

Today we will hear the testimony of top officials of the five Federal regulatory agencies with responsibility for the financial soundness of federally insured depository institutions.

They have been asked to appear this morning to report on the financial condition of the institutions under their agencies' jurisdiction.

It's been over 5 years since this committee conducted an in-depth review of general financial soundness. The last hearing of this sort was held in 1980. Prior to that, these hearings had been held annually. It is my intention to reinstate that practice.

The general financial conditions of federally insured depository institutions and their holding companies is of such vital importance it should be reviewed by Congress at least once a year, particularly in view of the enormous debt problem we have not only for the Federal Government and for consumers but for corporations.

Now this hearing is also the first of a series of comprehensive hearings on the appropriate activities of depository institutions and the companies that own them. I say this with the assumption that our House colleagues will agree to go to conference on a broad range of issues in H.R. 27 as amended by the Senate last week. When the Senate voted last week 93 to 3 to include H.R. 27, the full text of S. 790, we did so for reasons that will become crystal clear as this hearing proceeds this morning.

The financial soundness of our federally insured depository institutions depends on closing the nonbank bank loophole and recapitalizing the Federal Savings and Loan Insurance Corporation.

We need to recapitalize FSLIC so it can stop the hemorrhaging of earnings that is now going on within the several hundred hopeless-

ly insolvent FSLIC-insured thrifts. We need to close the nonbank bank loophole to economize on FSLIC's rehabilitation efforts and to prevent a free-wheeling disintegration of the banking-commerce separation and the enormous safety and soundness risks this would entail.

If we fail to close the nonbank bank loophole, businessmen will begin to enter the banking industry just as a few years ago they entered the thrift industry where a State law permitted.

Direct real estate and commercial investments, the shopping centers, windmill farms, and restaurants that some thrift institutions made under the authorities granted by direct State legislatures contributed heavily to the FSLIC current problems. This we know is fact.

A recent FDIC survey of bank powers authorized by the States indicates that the powers are broader than previously thought in the area of direct equity investment in commercial and real estate enterprises. This situation is worrisome without the potential for nonbank banking. If we fail to close the nonbank bank loophole, it is a formula for disaster.

On questions regarding the soundness of our insured institutions, we must ask the bankers with their briefcases filled with bland assurances to stand aside. We must get beneath the hand-waving obfuscations of the regulators. We must obtain the critically needed data and face the cold realities ourselves.

Let's look at three of the realities now. First, the examination resources of the bank regulatory agencies may be inadequate to deal with the current risks in our financial system. The banking agencies were asked to furnish us with the number of examiners and the total deposits of the institutions they examined annually since 1975. This information reveals that the number of examiners in the banking agencies actually declined in the early 1980's and began to increase again only in the last few years.

The Comptroller of the Currency and the FDIC still have fewer examiners than they had in 1978. But this is not the whole story by any means.

Let's look at chart I (p. 218), on my left. When we compare the number of examiner bank hours, the sum measure of increasing bank size and complexity, we use total deposits in constant 1986 dollars, a very conservative measure. We find that the situation at the FDIC and the Comptroller's office is worsening. Examiner man-hours per million dollars of constant dollar deposits is declining. Only the Federal Reserve has been able to increase its examiner resources in relation to deposits.

Unfortunately, the total deposits of the banks examined by the FDIC and the Comptroller are 5½ times larger than the deposits of the banks supervised by the Federal Reserve.

Overall, then, our examiner staff is probably decreasing in relation to the job it has to do.

Here's another cold reality. The banking agency data shown in the lower left, chart II (p. 219), reveals that the number and total deposits of problem banks has risen steadily since 1980, despite one of the longest periods of economic recovery on record.

Usually after a recession the number and volume of problem institutions declines. Not so this time. The increase in the number of

problem institutions is accounted for by smaller agricultural and oil-related institutions and the increase in the total size of problem institutions is accounted for by increasing problems among the large institutions.

In the judgment of this Senator, the uptrend in problem institutions during this long period of recovery raises an important question.

What is going to happen in the event of a recession?

If that is not enough, here's another cold reality to think about. No one, not us, not the private banking analysts, not even the regulators, really know what the true capital position of our largest banks is.

On chart III (p. 220), to the bottom right we see three different capital ratios for the largest 25 U.S. banks. The top one is simply the ratio of primary capital to total assets. The middle one is primary capital to total asset plus a weighted amount of off-balance sheet obligations—those invisible but very lucrative off-book transactions that carry with them very real risks. The bottom one is primary capital as a weighted amount of substandard, doubtful, and loss assets to total assets, plus off-balance sheet obligations. The bottom ratio line includes the most factors and is the most informative.

Now that looks simple, doesn't it? Let's look a little closer. First at the off-balance sheet items. I am informed that the reporting of them to the regulators is incomplete, that the banks report some of the most important items to be sure, but the kinds of these items are growing so fast regulatory reporting can't keep up.

In addition, the off-balance sheet phenomenon itself is so new the regulators have very little direct loss experience on which to base the percentages they use to weight the relative risk of the various items. The percentages are little more than educated guesses.

Finally, for the problem loan issue, chart IV (p. 221). The footnotes in the agency provided tables in yesterday's Citicorp announcement tell it all. The LDC debt is not reflected in the nonperforming loan and capital tables and it should be. Citicorp yesterday set aside reserves equal to 25 percent of its LDC debt. If we were to take this amount out of the Citicorp reported capital for year end 1986, its reported capital would be significantly lower and the results would be far more accurate in number.

When the time for questioning begins, I will ask the regulators to tell us what the year end 1986 capital positions of the largest U.S. banks are, including a 25-percent deduction for LDC debt. We must know this if we are going to understand fully the financial conditions of our banking system.

When all is said and done, the public does not turn to the regulators for reassurance in times of crisis; it turns to Congress. It is on our shoulders the final responsibility rests.

Senator Garn.

OPENING STATEMENT OF SENATOR GARN

Senator GARN. Thank you, Mr. Chairman. I certainly wish to commend you for holding these hearings on the financial soundness of federally insured depository institutions. As the financial

markets continue their rapid change, it's important that we keep an eye on the industry's vital signs.

Although we already know about the dire straits of FSLIC, maybe Congress needs to hear it again before it's convinced that this really is an emergency. I certainly hope that's the result. I would certainly be interested to get an update on the regulatory responses to the record number of failing banks as well.

Since we passed a clean FSLIC last October in the Senate, I would repeat what I said on the floor last week, that the General Accounting Office study has shown that rather than losing $6 million a day, FSLIC is losing $10 million a day; rather than being $3 billion in the red, we are $6 billion in the red.

Not only has Congress been unwilling to approve a clean FSLIC in a very serious emergency situation, we haven't even extended title I and title II of Garn-St Germain which expired last October 1. Congress certainly has not been willing to act.

I have only one disagreement with the chairman's opening statement, and that is that we have held no hearings with the regulators on oversight of the problem of financial institutions since 1980. Maybe we didn't call them specifically that, but I would suggest that these gentlemen and former comptroller Conover and their predecessors have been before this committee numerous times every year since 1980. Certainly there is a voluminous record from the Federal Reserve Board and the other regulators about these regulatory problems for every year since 1980.

So this committee has been keeping track of the regulators, as we should, and I commend the chairman for holding these hearings.

I know one indicator that I find very encouraging. The chairman's probing questions in organizing these hearings have produced a wealth of data about the current capital position of banks. The one consistent thread running through all the various tables and charts is that banks have substantially increased their capital, no matter how you measure it. They have done it without Congress holding a gun to their heads by telling them how much they should reserve and against what they should reserve it. That is as it should be.

In fact, one of the few good things this committee did at Tuesday's markup of the trade bill was overwhelmingly vote to strike a provision that would mandate new reserves in connection with Third World debt. The bank capital statistics made available for this hearing are just further proof that this committee's decision was the right one.

So was Citicorp's decision yesterday to add $3 billion to its reserve voluntarily without congressional meddling, based upon an evaluation of its own individual circumstances. It shows clearly that Congress does not need to micromanage every bank's balance sheet. Some banks may follow Citicorp's lead. Others may be persuaded by the regulators, while others will find no action necessary, depending on the condition of their own balance sheets. Again, that is how it should be, which is what the market seems to think as well since Citicorp and several other banks stocks rose following the announcement while declines were minimal.

To state that a bank's decision to raise reserves voluntarily is proof that we need to dictate more reserves is surprising. All the evidence—the bankers' actions since 1983, the Federal bank regulators 'actions and advice, and Citicorp's action of yesterday—at least lead this Senator to the conclusion that no statutory authority is needed.

Again, I would hope the review of the condition of the S&L industry will help convince my colleagues in both the House and the Senate the urgency of a clean FSLIC recap and addressing that problem as rapidly as we can.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Garn. Senator Garn, there's a roll call. I'm going to run and if you could stay here until the 5-minute bell and then I'll run over and vote and come back as quickly as possible so we hold up the hearing as short a time as possible.

Senator GARN. Senator D'Amato.

Senator D'AMATO. Mr. Chairman, if I might, I'm not going to take the time of this committee other than to welcome all of our witnesses and ask that my statement be placed in the record as if read in its entirety.

Senator GARN. Senator Dixon has requested that his statement be included in the record.

STATEMENT OF SENATOR ALFONSE M. D'AMATO

Senator D'AMATO. The committee once again invokes its oversight authority to examine the safety and soundness of the banking system. Although the committee has had several hearings on this topic in recent months, constant vigilance over the condition of our financial system is needed.

The financial markets of the country, and especially the banking system, are experiencing profound changes. Each day we read of record numbers of bank and thrift failures. The coditions of loans to the Third World are a constant threat to the safety and soundness of our domestic banking system. This threat is real and most recently manifested itself in Citicorp's decision to increase its loan loss reserves by $3 billion.

Each morning bad news about the state of the FSLIC fund awaits me when I enter the office. The most important task which this committee faced has only been partially accomplished. I believe we have acted responsibly by quickly reporting and passing legislation that recapitalizes the FSLIC fund. While we have passed a FSLIC recap plan, the FSLIC fund will be imperiled until the bill is signed into law. While I had hoped that we would allocate more than $7.5 billion for the recapitalization plan, I think we can work to secure higher funding in conference, if we ever get there. Finally, I hope that the funds ultimately allocated under the recap plan will not be unduly encumbered by certain forbearance provisions. Overly restrictive forbearance requirements will totally gut the recap plan and the industry the plan was designed to help will only further be weakened.

We hear a lot of talk on this committee about the perceived erosion of our preeminent position as the world's financial center.

This committee also has entertained many notions for the perceived erosion of our status. While both the erosion itself and the causes of it are topics for lengthy debate, the loss of status will become very real if we lose the status of having the safest and soundest financial system in the world.

I look forward to the testimony of today's witnesses and hope they will level with us on the current state of the safety and soundness of the system and its prospects for the future. I think the debate should focus on what the banks need to do to ensure their health and viability without suggesting that the quick fix will occur only if they are given more powers. They don't need more powers. They do need to do a better job in their traditional lines of business, expanded powers will not have any real impact on the financial position of an overwhelming majority of this country's banks.

STATEMENT OF SENATOR ALAN DIXON

Senator DIXON. Mr. Chairman, I am pleased to be here this morning as the Senate Banking Committee examines the financial soundness of federally insured banks and thrifts. We have a distinguished group of Federal banking, thrift, and credit union regulators before the committee today, and I look forward to hearing their testimony.

This is a tough time for our depository institutions. There are almost 1,500 banks on the FDIC problem list—a record number. Banks are failing at the rate of 150 per year. The thrift industry problems are significantly worse; the problems facing S&L's have been so serious that the FSLIC fund itself needs major additions to its capital.

It is worth noting, however, that the banking industry has improved its capital position—increasing the ratio of primary capital to total assets from 4.78 in 1982 to 6.72 in 1986—even as the number of failures has increased. Even the more troubled thrift industry's overall capital position has improved.

As important as capital adequacy is, then, it cannot be the sole focus of our investigation. It is important to remember that depository institutions have basically only two ways to add to their capital; they can make additions from internal sources, or they can raise it in financial markets. In either case, the ultimate ability to raise capital depends on a healthy earnings stream.

It does no good, for example, to raise capital requirements if the result of the increase is to force depository institutions to go into making riskier loans in order to generate the profits necessary to try to raise the new capital. I hope, therefore, this committee will soon begin its hearings on the comprehensive financial services legislation that we really need to modernize our regulatory structure, and to bring it into line with current market realities. We need to ensure, on the one hand, that our depository institutions are properly safeguarded against risk. However, we also need to ensure, that they have the ability they need to compete with their less regulated competition from other segments of the financial services industry.

I would also like to take this opportunity to briefly comment on Citicorp's announcement on Tuesday that it was making a $3 billion addition to its loan loss reserve. On Tuesday, by a vote of 15 to 5, the Banking Committee decided not to impose additional reserve requirements on banks based on their troubled Third World debt exposure. The committee reached this decision not because it doesn't want to know, or doesn't care about Third World debt issues, but because it believes the banks have taken and are continuing to take the steps necessary to protect their depositors and their safety and soundness, and because the regulators already have the authority they need and have taken the steps necessary to vigorously monitor the foreign debt situation and to protect the integrity of our banking system.

Citicorp's announcement, while dramatic, is simply the latest demonstration that our banks have done and are doing what we asked them to do in 1983. They have increased their capital, and they are taking the steps necessary to face their problems.

I would like to make only one other point about the Citicorp announcement, which is, that Citicorp is much more heavily exposed in Brazil than our other money center banks, and therefore, it does not automatically follow that the rest of our banks should be required to make similarly dramatic additions to reserves. I was pleased to see that the Federal banking regulations are taking that position. I urge my colleagues to see this action for what it is—an indication that the existing system is responding to the Third World debt problems and that our banks are taking the hard actions necessary to preserve their safety and soundness.

We do not need additional legislation to try to micromanage individual banks' capital and reserves positions. Tuesday's announcement shows that the banking industry and the banking regulators are working well to manage a difficult and complex problem. Tuesday's vote in the Banking Committee, though it occurred before the announcement, was the right response.

Senator GARN. Mr. Clarke, would you like to begin. I notice I started backward. I hadn't looked at the panel but you're on the right moving that way, so as long as I've started in the wrong direction we'll continue that way.

Mr. CLARKE. Well, I hope my statement doesn't lead us in the wrong direction. [Laughter.]

STATEMENT OF ROBERT L. CLARKE, COMPTROLLER OF THE CURRENCY

Mr. CLARKE. Mr. Chairman and members of the committee, I am here today to respond to your invitation to discuss the current condition of the national banking system and to answer other questions that you have asked. The condition of the national banking system is sound. In the face of some adverse conditions, public confidence in banks remains generally high. This is a tribute to the resilience and underlying strength of the banking system. But as you will note in the written statement which I have submitted, there are some disturbing trends which, if they persist, raise concerns about the future.

Industry profitability, as measured by the median return on assets, declined for the sixth consecutive year in 1986 and nearly one in five national banks lost money. From a supervisory perspective, this raises a number of concerns. Most obviously, earnings are a direct source of capital for the banking industry. The higher a bank's earnings, the greater is its ability to augment capital internally. But equally important, a bank's ability to obtain externally generated capital is dependent on its profitability and attractiveness as an investment.

Unfortunately, there is no single, simple explanation for the problems affecting banks, particularly the decline in profitability. There are several forces at work. I will focus my comments on two principal ones—eroding asset quality and increasing competition.

TWO PRINCIPAL PROBLEMS AFFECTING BANKS

Most credit-quality problems have been concentrated in economic sectors hurt by disinflation in land or commodity prices, such as agriculture and energy. I expect some banks in agricultural areas to report improved earnings this year. Many of them have identified their problem loans and have built up reserves. We have encouraged them to work with their borrowers in restructuring problem loans where there is promise of recovery. Most have also been more conservative in providing new loans. Nevertheless, conditions in the farm belt remain depressed, and many banks in agricultural areas will continue to suffer from poor asset quality and low earnings.

Banks located in areas dependent on the oil and gas industry will carry a heavy burden of problem loans for some time to come. While the increase of crude oil prices during the past 6 months has lessened some of the financial pressure on borrowers in the energy industry, the domestic U.S. oil and gas business is still shrinking. Given the downturn in the domestic oil industry in recent years, any significant recovery in that industry will likely take time, even if prices move substantially above current levels.

Unfortunately, the energy downturn has severely affected the real estate portfolios of many of the same banks. Overbuilding, industry contraction, and weak local economies have led to high vacancy rates for commercial real estate and increasing residential foreclosure rates in the energy producing regions of the Southwest.

History has shown that such economic cycles correct themselves as supply and demand move closer to equilibrium. But bankers and bank supervisors continue to be challenged in their strategies to deal with these problems during the often extended correction periods.

Earnings at large multinational and some regional banks are also suffering as a result of loans to less developed countries, many of which have found it difficult to service their debts. Obligations of some of the larger countries, such as Brazil, have recently been placed on nonaccrual status, reducing earnings of their principal lending banks. Debt reschedulings have occurred, particularly in the form of extensions of repayment periods, and deterioration in the quality of some country debt has resulted in mandated reserves pursuant to the International Lending Supervision Act of 1983.

INTERNATIONAL DEBT

Although some debtor countries have made progress toward restoring their liquidity, adjusting their economies, and servicing their debt obligations, we see no quick end to the international debt problem. Its resolution can only come from deliberate and concerted collective efforts among the debtors and their lenders within a generally favorable global economic climate. These efforts must have as their objective a true improvement in the economic capacity of the debtor countries or we will continue to face crises in the short term. Clearly, it is in the long-term interests of the debtor countries to repay their obligations in order to maintain their access to world capital markets. We are encouraged by renewed economic reforms and recently completed debt negotiations in a number of countries. At the same time, we will continue to encourage banks with significant international exposures to build equity capital and reserves.

Senator GARN. Mr. Clarke, I'm sorry to interrupt you. I'm not quite as fast as O.J. Simpson, even though I won't have to carry a bag to the Capitol, but the committee will stand in recess until the chairman comes back and then I will also return. Thank you very much.

[Recess.]

The CHAIRMAN. Mr. Clarke, I understand you have 5 minutes left. Go right ahead.

Mr. CLARKE. Mr. Chairman, my only regret is that you were not here since I was so proud of myself for having gotten my statement down below 10 minutes. Now you will never know whether that was true. [Laughter.]

While bank management, in general, appears to be aggressively addressing their present asset quality problems, there is a disturbing longer-term trend that indicates that profitability and asset quality may continue to deteriorate.

Current restrictions on banks' ability to diversify their assets and sources of income make it cumbersome, if not impossible, to restructure the products and services they offer in line with changing market conditions and consumer demands. Furthermore, only if banks have the authority to deliver the products customers demand will they be able to earn returns that can attract capital.

This need is felt by small banks as well as regional and money center institutions. Whether it is underwriting revenue bonds, managing mutual funds, purchasing security interests in loan pools, selling insurance, or involvement in real estate investment activities, banks, large and small, are limited in their ability to meet their competition on equal terms and to have at least a fair chance at retaining their customer relationships. Many of these new activities, in my judgment, involve less risk than much of the lending that is an established part of commercial banking.

Expanded opportunities for diversification would not only permit banks to respond more effectively to market conditions, but they would also make banks less susceptible to a downturn in any particular industry or sector of the economy. Like capital, diversification of risk and earnings sources is a protection for depositors and the insurance fund. Until banks are given greater competitive

flexibility, I am concerned about the potential for a gradual erosion of the safety and soundness of the banking system.

Neither the business of banking nor bank supervision is as routine as in the past. In my written statement, I have addressed the OCC's strategies for supervision of banks and, as you requested, I have pointed out the status of our examination force and some of the difficulties we face in maintaining a staff of adequate size and experience.

Bank supervision requires the exercise of judgment, patience and, above all, an environment of flexibility to adapt to sometimes rapidly changing circumstances. However, mandatory loan loss deferrals and other bad accounting practices have no place in the system of prudent bank supervision. Neither do legislated forbearance policies such as those adopted by the House in connection with the recapitalization of FSLIC. Nor should there be legislatively mandated reserves for any type of credit exposure—international or otherwise. Supervisory flexibility is the foundation upon which a safe, sound, and competitive banking system must be structured.

Certainly, we all share a common objective—a safe and sound banking system. As I have indicated, I believe that we have one today. Let's make sure that we have one tomorrow.

Thank you.

[The complete prepared statement of Robert L. Clarke follows:]

For Release 10:00 a.m., May 21, 1987

STATEMENT OF
ROBERT L. CLARKE
COMPTROLLER OF THE CURRENCY
before the
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE
May 21, 1987

Mr. Chairman and members of the Committee, I am here today to respond to your invitation to discuss the current condition of the national banking system and other matters. In summary, the national banking system is sound and public confidence remains generally high. However, it must be noted that a significant number of national banks lost money in 1986, and banking industry profitability has declined for the sixth consecutive year. Asset quality, particularly among banks in certain areas of the country adversely impacted by depressed agriculture and energy-related economies, is deteriorating. And, in 1986 national bank failures reached their highest level in years, although the size of the failed institutions was generally small.

Bank managers appear to be aggressively addressing their asset quality problems and, as troubled sectors of the economy improve, some of the national banks with losses in 1986 should return to profitability.

There is a disturbing longer term trend, however, which indicates that profitability and asset quality may continue to deteriorate. In addition to the sectoral economic problems, commercial banks face increasingly intense competition. Current laws and regulations limit the ability of commercial banks to respond to this competition. I am concerned that unless something is done to give banks additional flexibility to respond to competitive pressures, there exists the potential for an erosion of the safety and soundness of the banking system.

In my testimony today, I will begin by reviewing data regarding current levels of bank capital, asset quality, earnings, and liquidity. I will also discuss the financial and operating characteristics of the ten largest national banks in order to respond to specific questions that were posed in your letter.

Following this data review, I will evaluate, in more detail, developments relating to agricultural lending, oil and gas lending, and international lending. I will then discuss the OCC's approach to supervising banks and ensuring compliance with laws and regulations. I will also describe our proposed risk-adjusted capital guidelines. After responding to several other concerns expressed in your letter, I will conclude by discussing my strong belief that banks need to have additional flexibility in determining the manner in which they can most effectively respond to the economic and competitive challenges they face.

THE FINANCIAL CONDITION OF NATIONAL BANKS

Earnings. In 1986, the profitability of national banks as a group declined for the sixth consecutive year. Nearly one in five national banks lost money in 1986, and many more national banks had inadequate earnings. The median return on assets (ROA) and the median return on equity (ROE) for all national banks were each about 30 percent below their levels in 1980, and they declined by approximately 10 percent in the past year alone. The aggregate net income of national banks fell last year, despite an increase in earning assets.

TABLE 1

RETURN ON ASSETS
(All National Banks)

Year	Median	Mean
1980	1.11%	0.73%
1981	1.08	0.71
1982	1.04	0.66
1983	0.97	0.60
1984	0.92	0.58
1985	0.88	0.63
1986	0.78	0.58

Source: Call Reports

TABLE 2

RETURN ON EQUITY
(All National Banks)

Year	Median	Mean
1980	13.93%	13.37%
1981	13.47	13.03
1982	12.97	11.90
1983	12.19	10.68
1984	11.56	9.96
1985	11.15	10.74
1986	9.59	9.84

Source: Call Reports

Unfortunately, there is no single, simple explanation for this decline in overall bank profitability; there are several forces at work. I will focus my comments on two principal factors, eroding asset quality and increasing competition.

The erosion in asset quality has been especially acute for banks located in areas with economies heavily dependent on agricultural or oil and gas operations. In those areas, local economic weaknesses have resulted in rising loan losses and diminishing loan demand. Greater chargeoffs have forced banks to increase loan loss provisions. This, of course, has reduced their earnings.

The increasing competition has come largely from non-bank providers of financial services. Traditional bank customers, both large and small, no longer rely solely on banks to provide their basic financial services, and banks face limitations on their ability to respond to the increased competition.

Whatever competitive advantage the typical insured commercial bank once had is fast disappearing. Since 1980, for example, banks' share of the automobile loan market has declined from 52.7 percent to 41.1 percent. Banks also have lost significant prime corporate customers to the commercial paper market, which has doubled in size since 1980. This has produced a corresponding reduction in the quality of their loan portfolios. The diminished quality of the loan portfolios has resulted in greater loan losses and a decline in earnings.

Banks have supplemented their loan income through securities trading and by offering services that generate fee income. In 1986, these noninterest sources of revenue, which include income from fiduciary activities, service charges, income from trading account activities, gains and losses from securities and foreign exchange transactions, and miscellaneous other noninterest income, amounted to $25.2 billion at national banks, compared to $8.5 billion in 1980. Noninterest income was nearly 45 percent as large as net interest income in 1986, compared to only 27 percent in 1980.

Two trends are evident in the data. First, the percentage of banking income coming from noninterest sources is increasing. Second, noninterest income makes a larger contribution to income at larger banks than at smaller banks.

TABLE 3

NONINTEREST INCOME AS A PERCENT OF NET INTEREST INCOME
(All National Banks)

Year	Median	Mean
1980	12.27%	27.09%
1981	12.67	29.45
1982	13.51	30.61
1983	14.98	34.74
1984	16.29	36.36
1985	18.14	38.71
1986	21.24	44.78

Source: Call Reports

TABLE 4

NONINTEREST INCOME AS A PERCENT OF NET INTEREST INCOME
(Ten Largest National Banks)

Year	Median	Mean
1980	32.14%	36.46%
1981	35.53	42.51
1982	40.03	41.60
1983	42.67	43.52
1984	42.26	44.37
1985	47.47	47.31
1986	57.02	56.84

Source: Call Reports

Asset Quality. National banks have suffered a pronounced decline in asset quality during the past five years. As will be explained in more detail later, the erosion in asset quality has many causes. Principal among them have been disinflation, sectoral economic weaknesses, and a narrowing of the universe of bank customers. The result has been a surge in loan losses.

TABLE 5

NET LOAN LOSSES AS A PERCENT OF AVERAGE TOTAL LOANS
(All National Banks)

Year	Median	Mean
1980	0.24%	0.37%
1981	0.26	0.35
1982	0.35	0.59
1983	0.34	0.70
1984	0.37	0.86
1985	0.55	0.88
1986	0.71	1.01

Source: Call Reports

Unfortunately, the future promises no quick turnaround. An increasing percentage of bank loans have interest or principal payments that are past due, some by more than 90 days. As a percentage of all loans, problem loans have risen by more than 20 percent in the past two years.

Capital. A bank's primary capital is a buffer available to absorb unexpected losses that cannot be covered by its current earnings. By providing such a buffer, primary capital reduces the probability of bank failure.

While there is ample room for disagreement as to what constitutes an adequate level of capital, I believe that the national banking system, as a whole, is adequately capitalized. In light of rising loan losses and regulatory encouragement, national banks have significantly augmented their primary capital during the past five years. Since 1980, primary capital at national banks has nearly doubled, rising from $65.9 billion in 1980 to $124.6 billion in 1986. Primary capital has increased relative to total assets as well. The average primary capital ratio was approximately 6.3 percent in 1980 and 7.5 percent in 1986.

TABLE 6

PRIMARY CAPITAL AS A PERCENT OF AVERAGE TOTAL ASSETS
(All National Banks)

Year	Median	Mean
1980	8.43%	6.27%
1981	8.41	6.33
1982	8.47	6.38
1983	8.46	6.59
1984	8.50	7.10
1985	8.51	7.34
1986	8.32	7.49

Source: Call Reports

Much of the increase in primary capital that has taken place has been in the form of additions to loan loss reserves. Typically, a bank adds to its loan loss reserve when it identifies areas of potential weakness in its loan portfolio. Thus one implication of the increasing level of reserves is that banks expect higher loan losses in the future. Another is that banks, by adding to the reserve, are taking steps to cushion future earnings against possible asset quality problems. Significantly, even without the reserve, bank capital has increased substantially since 1980.

TABLE 7

AVERAGE EQUITY CAPITAL AND LOAN LOSS RESERVES RATIOS
(All National Banks)

Year	Equity Capital / Assets	Loan Loss Reserves / Assets	Primary Capital / Assets
1980	5.70	0.57	6.27
1981	5.73	0.60	6.33
1982	5.73	0.65	6.38
1983	5.87	0.72	6.59
1984	6.11	0.81	7.10*
1985	6.17	0.93	7.34*
1986	6.16	1.09	7.49*

*Includes minority interests and qualifying mandatory convertible debt.

Source: Call Reports

The increase in capital has been most pronounced at the largest banks. The median primary capital ratio at the ten largest national banks increased from 4.6 percent in 1980 to 6.9 percent in 1986. All have capital within current regulatory guidelines.

Liquidity. Liquidity is a bank's most important safeguard against funding difficulties. Even the most well-managed banks may be vulnerable to a sudden erosion of market confidence. For that reason, the OCC monitors the diversity and stability of funding sources and the liquidity of assets, particularly at the largest banks.

Bank liquidity positions have improved since 1980 as dependence on volatile liabilities has lessened. Increased bank competitiveness for retail deposits and lessons derived from the experience of Continental Illinois National Bank have caused many bank managers to reduce their dependence on wholesale funds and to seek more stable retail deposits. This trend has been evident at banks of all sizes.

TABLE 8

VOLATILE LIABILITIES AS A PERCENT OF TOTAL ASSETS
(All National Banks)

Year	Median	Mean
1980	9.97%	43.51%
1981	11.26	45.07
1982	11.44	43.32
1983	10.33	38.92
1984	11.72	37.04
1985	11.85	37.06
1986	10.81	35.36

Volatile liabilities are defined as all time deposits over $100 thousand, foreign-office deposits, federal funds purchased and securities sold under agreements to repurchase, interest-bearing demand notes issued to the U.S. Treasury, and other liabilities for borrowed money.

Source: Call Reports

The effect of brokered deposits on national bank liquidity remains quite small. As of December 31, 1986, only 338 national banks, or less than 7 percent of all national banks, reported any brokered deposits. At most of these banks, brokered deposits comprised less than five percent of total deposits. The use of brokered deposits, however, does raise supervisory concerns, particularly among troubled banks. Therefore, the OCC exercises a wide range of restrictions and limitations on brokered deposits on a case-by-case basis.

Failed Banks. More banks failed in 1986 than in any year since 1933. A total of 136 insured commercial banks failed, of which 48 were national banks. An additional seven banks were granted open bank financial assistance by the FDIC. As of May 15 of this year, 75 insured commercial banks had failed, 30 of which were national banks. Three banks had been provided open bank assistance.

Two points should be made concerning bank failures. First, failed banks are generally very small. Only three failed banks in 1986 had more than $100 million in assets. Total failed bank assets amounted to $6.9 billion last year, or approximately 0.3 percent of all commercial bank assets. The national banks that failed in 1986 had $3.2 billion in assets, or 0.2 percent of all national bank assets. Half of that total, $1.6 billion, was the result of one failure. Asset size at the other failed national banks averaged $35 million.

Second, the majority of national bank failures last year were located in areas of the country that have experienced economic problems in agriculture and energy. In 1986, 17 national agricultural banks and 13 national energy banks failed; these banks represented more than 60 percent of all national bank failures. Two-thirds of all national banks that failed last year were located in just four states, each with extensive agricultural or oil and gas activity -- Texas, Oklahoma, Iowa, and California.

Problem Banks. As with failed banks, the number of problem banks has increased rapidly since 1980. As of May 12 of this year, seven percent of all national banks, 319 in total, were on the list of problem institutions (those with CAMEL ratings of 4 or 5). This compares to about one percent of national banks, 51 in total, in 1980.

ASSET QUALITY PROBLEMS: A CLOSER LOOK

A continuing source of concern about commercial banks, including national banks, has been the rise in problem assets and loan chargeoffs through the fourth year of the economic recovery. Most credit quality problems have been concentrated in economic

sectors hurt by disinflation. In addition, large multinational banks and some regional banks have faced difficulties from substantial exposures to economically distressed Latin American countries.

Sectoral Economic Problems. The financial stress faced by borrowers in economic sectors dependent on agriculture and the oil and gas industry has been well publicized. Though there is some room for optimism, it is not clear today that conditions in either economic sector will improve substantially in the near-term.

Rapid increases in the productive capacity of foreign agricultural producers will make it difficult to return to previous levels of U.S. agricultural exports. U.S. agriculture still carries a heavy debt burden and is challenged by ongoing productivity increases and weak commodity prices. Although recent reports suggest that farm land prices may be stabilizing and optimism is expressed about farm incomes for 1987, these developments appear to be largely dependent on the continuation of substantial federal government agricultural subsidies.

Many agricultural banks have identified their problem loans and have built up reserves. We have encouraged them to work with their borrowers in restructuring problem loans where there is promise of recovery. Most banks also have been more conservative in providing new loans. While I expect that some agricultural banks will report improved earnings this year, many banks in agricultural areas will continue to suffer from poor asset quality and low earnings. Until these banks are able to diversify their asset portfolios and income sources, they will remain highly vulnerable to downturns in the agricultural sector.

Similarly, prospects have not brightened materially in the oil and gas industry. While the increase of crude oil prices during the past six months has lessened some of the financial pressure on borrowers in the energy industry, the domestic U.S. oil and gas business is still shrinking. Given the damage to the domestic oil industry in recent years, any significant recovery will likely take time, even if prices move substantially above current levels.

The volume of nonaccrual oil and gas loans declined slightly in the last quarter of 1986. Oil and gas nonaccruals still remain about four times higher than the national average for commercial loans, however. Like banks in the farm sector, banks in areas of the country heavily dependent on oil and gas production will carry a heavy burden of problem loans for some time to come.

A third source of concern for banks is their real estate loans. High levels of nonperforming real estate loans may adversely affect future earnings at some banks. Overbuilding, industry contraction, and weak local economies have led to high vacancy rates for commercial real estate and increasing residential foreclosure rates in many areas, particularly in the energy-producing regions of the Southwest. In these areas, the volume of problem real estate loans is rising, and further deterioration may occur.

International Lending. Earnings at large multinational and some regional banks are suffering as a result of loans to less developed countries, many of which have found it difficult to service their debts. Obligations of some of the larger economies, such as Brazil, have been placed on nonaccrual status, significantly reducing earnings in some banks. Debt reschedulings, particularly in the form of extensions of the repayment period, have occurred, and deterioration in some country debt has resulted in mandated reserves pursuant to the International Lending Supervision Act of 1983.

Some debtor countries have made progress toward restoring their liquidity, adjusting their economies, and servicing their debt obligations. These efforts have been assisted by financial arrangements from creditor banks, creditor countries, and multilateral institutions.

Nevertheless, we see no quick end to the international debt problem. Its resolution can only come from deliberate and concerted collective action within a generally favorable global economic environment. We expect such collective action to continue, as evidenced by renewed economic reforms and recently completed debt negotiations in a number of countries. Individual countries will progress differently because of their varying internal political processes, as well as their specific susceptibilities to the global markets for their exports and imports. In the meantime, we will continue to encourage banks with significant international exposures to build capital.

CURRENT SUPERVISORY INITIATIVES

As the supervisor of the national banking system, the OCC plays an important role in minimizing the negative impact that national bank failures and troubled national banks can have on the safety and soundness of the banking system. The success of our supervisory efforts cannot be judged, however, simply by looking at the rate of bank failures. Our supervisory system is not designed to eliminate bank failures; to do so would require either the nationalization of the banking industry or the elimination of all risk -- one consequence of which would be to preclude banks from playing an active role in funding the nation's economic growth.

In today's era of economic volatility and changing market forces, bank supervision is increasingly challenging. We have undertaken several initiatives aimed at enhancing our ability to support systemic stability.

Methods of Supervision. The volatility of economic conditions presents challenges to bank directors and managers. A recent analysis, by a former Federal Reserve System economist, found that inadequate management practices were typically the direct cause of problems at banks whose difficulties came to light in 1984, 1985, and 1986. The importance of management was also emphasized in a recent speech by John G. Medlin, Jr., the president and chief executive officer of First Wachovia Corporation. Mr. Medlin noted that one of the answers to the challenges facing bankers today "... may be found in reviewing the nature of banking and examining the principles of good management."

As bank supervisors, we have found that we can be most productive by focusing on the risks to the system as a whole and concentrating on those risks before they result in systemic problems. A large part of that involves evaluating how well bank management is able to anticipate and deal with problems at their respective banks when the problems arise. Examination resources are now being allocated on the basis of our judgment of where systemic risks to banking lie. Our approach to supervision relies on the knowledge and ability of examiners to tailor our supervisory efforts to each bank.

Our supervisory approach is intended to ensure that banks have the systems and controls required to anticipate and identify risks and to deal with problems as they occur. Instead of concentrating on the evaluation of individual transactions -- as was done in the past -- we are redirecting our examination attention to the systems and controls under which bankers make transaction decisions and monitor their results. Management is being held accountable for those systems and their operation. We are also putting greater emphasis on the role of bank directors. To underscore this emphasis, we are developing a manual for bank directors that will provide practical guidance regarding their responsibilities.

This approach to bank supervision, of course, cannot prevent all cases of fraud or insider abuse or eliminate all bank weaknesses that are attributable to problems with asset quality. Nor can any other approach. But it will enable us to identify problems early and direct banks to correct problems that could represent a danger to the entire banking system.

Compliance. Our approach to assessments of bank compliance with the law has been designed to complement our techniques for supervision. It is aimed at ensuring that banks have in place the systems and controls that will enable bank management to assess accurately their bank's compliance with the law and take corrective action when necessary.

The basis of our ongoing evaluation of compliance will be a stratified random sample of national banks drawn at the beginning of each examination cycle. We expect to complete each cycle within one year. The sample will have proportionately more large banks than small ones. Activities of banks in the sample will be examined thoroughly. Information from those examinations will be used to determine the extent to which compliance problems related to particular areas are likely to exist in other national banks or in the system. These data will enable us to provide guidance to banks and examiners to deal with specific compliance problems. Importantly, by providing specific guidance to banks in identified problem areas and emphasizing the importance of banks' systems of ensuring compliance, we will be able to make the most efficient use of our limited resources. We will, of course, continue to require banks to correct practices that result in violations of law or reflect weaknesses in controls.

I would emphasize that our new approach goes beyond areas typically associated with "compliance". Areas incorporated for examination under the compliance program are: consumer laws, trust activities, EDP, Bank Secrecy Act requirements, the accuracy of regulatory reports, insider transactions, discount brokerage, new government securities regulations, and Municipal Securities Rulemaking Board requirements.

Risk-Adjusted Capital Requirements. You have also asked for comments on the proposed risk-adjusted method for assessing the adequacy of bank capital. The current minimum capital ratios are based on balance sheet assets without regard to the risk associated with those assets. Moreover, they do not incorporate off-balance-sheet exposures, such as standby letters of credit and loan commitments. The risk-adjusted capital standard that is being proposed by the OCC, along with the Federal Reserve Board, the FDIC, and the Bank of England, is a first step toward including differences in risk represented by different types of assets and including off-balance-sheet activities in the determination of minimum levels of capital.

The current capital standards imposed by the three federal bank regulatory agencies base a bank's minimum required level of capital on its total assets. Banks must have primary capital equal to at least 5.5 percent of total assets and total capital equal to at least 6.0 percent of total assets. Off-balance-sheet exposures are not included, and the same capital ratio is required for both liquid and illiquid assets and for both high- and low-risk assets. Nonetheless, as determined during the examination process, banks taking more than the usual amount of risk are required by bank supervisors to have capital levels in excess of the minimum.

An unintended effect of the current standard is that in attempting to meet their required capital-to-assets ratios, banks may be inclined to hold riskier, less liquid assets and to shift more of their activities off the balance sheet. For example, the proportion of bank assets held as cash and U.S. Government securities declined from 29 percent in 1976 to 17 percent in 1986.

Motivated in large part by the competitive pressures facing banks and by restrictions in their ability to meet that competition, there has been a rapid expansion in fee-generating, off-balance-sheet activities, particularly at large banks. For example, at the ten largest national banks, standby letters of credit grew from $23 billion (or 5.0 percent of assets) in 1980, to $72 billion (or 13.1 percent of assets) in 1986. Loan commitments exceed one-third of total assets at those large banks, although they have grown no faster than on-balance-sheet assets since 1980.

Our efforts to develop risk-adjusted capital requirements have been misinterpreted by some as a subtle means of requiring increased capital in the banking industry. That is not the case. Rather, the intention is to develop an approach to measuring capital adequacy that more accurately relates an individual bank's capital to the risks it assumes. Additionally, the approach to capital adequacy will encourage banks to adjust the scope of their operations to fit better their capital structures.

Because implementation of the risk-adjusted capital proposal will require changes in the information received from banks, complete data that would enable us to make accurate calculations of banks' risk-adjusted capital ratios are not yet available. However, by making some assumptions about the characteristics of certain assets and off-balance-sheet items (for example, maturity and type of customer), we are able to make some rough estimates. For year-end 1986, estimated risk-adjusted capital ratios at the ten largest national banks range from 5.9 percent to 8.3 percent, with the average ratio equal to 6.6 percent. For year-end 1985 the estimates range from 5.5 percent to 8.4 percent and average 6.5 percent.

These risk-adjusted capital ratios are not directly comparable to capital-to-total-assets ratios. The risk-adjusted capital ratio measures the level of a bank's capital as a portion of its risk-adjusted assets, rather than total assets. The level of risk-adjusted assets is calculated as a weighted sum of balance sheet assets and off-balance-sheet activities, where the weights are determined by the riskiness of the asset or activity. The minimum risk-adjusted capital that will be required has not yet been determined.

ADDITIONAL CONCERNS OF THE COMMITTEE

Several other topics were mentioned in your letter of invitation, Mr. Chairman. I will now turn to those issues.

Double Leveraging. Double leveraging is the term given to the issuance by a parent bank holding company of long-term debt, the proceeds of which are invested as equity capital in one or more subsidiary banks. There is nothing unique about this method of financing the operations of banking subsidiaries. Like any other holding company, a bank holding company's ability to service its debt is generally dependent on the successful operations of its subsidiaries and the ability of those subsidiaries to pay dividends. If the operations of its subsidiaries require a reduction of dividends, a holding company's ability to service its debt may be jeopardized.

In the context of a bank holding company, this corporate financing technique can have implications for the capital adequacy of the bank subsidiaries. National bank examiners, when evaluating a bank's capital plan and dividend practices, consider the parent company's current and future cash-flow needs. We have the authority to limit a bank's payment of dividends and otherwise restrict flows of capital from the bank to its parent when capital is needed in the bank. In our judgment, double leveraging, as a financing technique, is not a cause for alarm.

Securitization. Regarding the Committee's questions about loan securitization, it is important to distinguish between two closely related practices. Loan securitization refers to the practice of pooling loans and then selling securities that represent interests in the pool. Such pools are similar to mutual funds. Banks are also extensively engaged in selling whole loans or parts of loans to others, expanding on a long-standing practice. Both developments are part of a natural evolution in the banking system. Each can significantly benefit the banking system by enhancing liquidity and providing opportunities to better manage risk. In particular, selling banks can continue to service single-industry communities without being totally dependent on the economic health of their local service areas.

We cannot, as yet, report with precision on the extent of each practice. Our data from large banks indicate that their loan sales totalled $70 billion in the last quarter of 1986, up from $30 billion in the last quarter of 1984. We understand that the majority of those sales were to other banks. We soon will begin collecting data on the purchase of loans by banks.

We do not regularly collect data on securitizations. However, banks wishing to undertake a securitization typically consult with staff at the OCC to ensure that their securitization plan is structured in a manner that will enable them to report the transaction as a sale, or a financing, as desired. To date, we have reviewed eight transactions by six banks. The value of the securities created in those transactions totalled $2 billion.

Some concern has been expressed that asset securitization will lead to banks selling their best assets and holding only those that, because they are of lesser quality, cannot be securitized. This concern is not validated by the transactions that we have reviewed. Banks do not simply securitize their best loans. Rather, they securitize whole groups of loans with similar characteristics. Most asset securitizations that have been undertaken by banks have involved mortgage loans, credit card receivables, or loans to finance the purchase of automobiles. Those loans are conducive to securitization because they are, for the most part, subject to standardized loan agreements and have relatively predictable loss patterns.

Typically, securitization works in the following way. A bank selects a portion of its loans for placement in a pool. The face value of the loans in the pool is determined and documents evidencing the loans are placed in the hands of a trustee. Securities representing an undivided interest in the pool are then sold to investors under conditions that transfer ownership of the loans from the bank to the investors.

The bank retains responsibility for servicing the loans, generally taking whatever steps are necessary to ensure that all the loans are paid off in accordance with their terms. Borrowers continue to make payments of interest and principal to the bank, and the bank passes on a portion of those receipts to the investors in accordance with the terms of the agreement with the holders of the securities. Under those arrangements, risks to the bank are minimal. There is ample income from the underlying loans to meet all required payments to purchasers of the securities, and, for the most part, loan defaults are the responsibility of investors.

Adequacy of Examination Staff. As of March of this year, the Office employed 1,943 field examiners. Despite annual staff increases approved by the Administration beginning in 1983, the OCC is 11 percent below the level of 2,157 field examiners it had 10 years ago. Significantly, ten years ago there were 33 national banks on the OCC's problem list; today there are over 300.

The mix of examiners by experience level, however, is currently of greater concern to us than the size of the examining staff. Unlike other professionals that we employ, virtually all of our examining talent is home-grown. We typically hire new college graduates, and following approximately five years of both formal and on-the-job training, qualified employees are commissioned as national bank examiners. Efforts are made to recruit personnel with banking, accounting, or other experience, but these efforts have met with only limited success.

Currently, a quarter of the field examiner positions that would ideally be staffed by commissioned national bank examiners are held by less experienced assistant and associate national bank examiners or are unfilled. Because of the number of years it takes to develop commissioned examiners, we project that this reliance on less experienced staff will continue for at least the next five years.

The shortage of experienced examiners may be attributed to several factors. Hiring freezes have left gaps in our experience levels. In 1986, the OCC instituted a hiring freeze in order to meet the Gramm-Rudman-Hollings sequestration.

Existing salary constraints also contribute to the problem. They impede our ability to compete with private-sector employers when recruiting prospective employees. But where the ceiling hurts the most is in the difficulty it creates in retaining staff -- seasoned with experience -- who want to make a career of professional bank supervision. The loss of career staff has been particularly serious in high-cost areas, where we do not currently maintain competitive compensation and benefit programs. The banking industry traditionally has used the OCC as a recruiting source, and recently, other federal regulators, who can offer higher salary potential than the OCC, also have hired our bank examiners.

As banks consolidate, particularly in reaction to a relaxation of geographic barriers, we expect the need for examiners in high-cost metropolitan areas will increase. As the scope of those banks' operations increases, the need for highly skilled and experienced examiners will become more acute.

Greater flexibility in our compensation program, would go far toward reducing examiner turnover and would enhance the attractiveness of a professional career with the OCC. We applaud Administration efforts, such as the proposed Civil Service Simplification Act, to address problems in federal compensation. There is, of course, no single, easy remedy. We recognize that development of a more complete solution must include reasonable controls on compensation levels consistent with overall fiscal responsibility.

CONCLUSION

Simply put, a large segment of the banking industry today is suffering from, and will continue to suffer from relatively weak earnings and poor asset quality. As described above, that performance is due, in part, to conditions in the sectors of the economy to which individual banks are exposed.

Weaknesses in the banking industry, however, go deeper. In some respects, the deteriorating condition of banks is made worse by the restrictions on their ability to diversify their assets and sources of income. Current restrictions make it cumbersome, if not impossible, for banks to restructure the products and services they offer in line with changing market conditions and consumer demands. Until banks are given that flexibility, there exists the potential for a gradual erosion of the safety and soundness of the banking system.

The members of this Committee are familiar with my views on the need for enhanced bank flexibility, which I presented in some detail when I appeared before the Committee in January, so I will not repeat myself today. I would, however, emphasize that while expanded activities are often viewed as an aid to large institutions, they would benefit smaller institutions as well. There are great opportunities for small banks to act as brokers in offering financial products such as mutual funds, or to enter into joint ventures with other banks for the delivery of those products. All banks should be able to pursue new profit opportunities in lines of business that have become an integral part of today's financial services marketplace.

Ultimately, however, the need for enhanced flexibility is a safety and soundness issue. Expanded opportunities for diversification would make banks less susceptible to a downturn in any particular industry or sector of the economy. Furthermore, only if banks have the authority to deliver the products customers demand will they be able to earn returns that can attract capital.

The CHAIRMAN. Thank you, Mr. Clarke.
Mr. Seidman.

STATEMENT OF L. WILLIAM SEIDMAN, CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION

Mr. SEIDMAN. Thank you, Mr. Chairman. I appreciate this opportunity to address the condition of the banking industry and to report on our insurance fund.

We have submitted written testimony for the record. I have reviewed the statements of my coregulators and we support their positions. My remarks today will give our own five key conclusions based on the data that we have submitted.

SUPPORT FOR REGULATORS

The first point is that the banking data provided by the FDIC and my fellow regulators demonstrate both strengths and weaknesses within the industry. The system remains viable despite the record number of problem and failed banks. In one sentence, on average, the system is adequately, but certainly not overcapitalized, less profitable than in previous years and becoming more efficient under the prod of deregulation and increased competition.

My second point is the industry averages mask some unsettling trends. The averages don't reveal that results of the banks west of the Mississippi are at all-time lows, while in the East banks are doing relatively well. I brought with me today final 1986 banking data—tables A and B—that will appear in the next issue of our new Quarterly Banking Profile, a copy of which is attached to my statement. This publication, which we publish every 3 months, is the most timely data available to the committee on the condition of the banking industry. I apologize for not submitting the data in the attached tables A and B earlier but they just became available last night.

I think these data reflect clearly the disparity among banks. For example, table A shows the aggregate return on assets for the banking industry was 0.64 percent, but this ranged from a negative 0.32 percent for banks in the Southwest to a positive 1.02 percent for banks in the Southeast. Over 80 percent of the banks that lost money last year were west of the Mississippi. Nonperforming assets represented 1.95 percent of the total industry assets but the ratio ranged as high as 4.08 percent in the Southwest and as low as 1.02 percent in the Southeast.

Table B shows the same data as table A broken down by size rather than geographic location. A quick review shows major differences among size groups. Aggregate earnings of small banks, those under $100 million, are way down compared to other banks. But, we believe it also reflects differences in banking structure. States in the Midwest and Southwest tend to have fairly restrictive branching laws which limit opportunities to diversify and therefore do not allow them to reduce risk.

Incidentally, there are a number of ways to compute averages—on aggregates or units—and, thus, you will note differences based on the computation method used. Consider the difference between the industry equity ratios. The unweighted average bank equity

ratio in table IV of our written testimony is 8.18 percent while the dollar aggregate when you just add up all the dollars against all the capital is 6.2 percent. Both ways of computing the "average" give us important insights in evaluating the system.

My third point is that while most of the recent bank failures can be attributed to weaknesses in well-defined sectors of the economy, it is clear that asset portfolio risk in the system is increasing. Both net charge-offs and nonperforming assets are increasing, even in areas of the country that have a robust economic base. Our experience in liquidating failed bank assets also reflects decreasing asset quality. Our loss rate on assets received from banks that failed during 1985 and the first half of 1986 show an increase of over 75 percent since 1980 and now we are losing about 25 percent on each dollar of assets. If failed banks located in the agricultural and energy sectors are excluded, the increase is still 60 percent.

We see a variety of reasons for the increased risks in bank portfolios. First, private debt in the economy has increased dramatically in recent years. Overall in our economy—both consumer and corporate—there is now about 40 cents more debt per dollar of income than there was just 5 years ago. Between 1981 and 1985, corporate debt jumped from 30 percent of net worth to 47 percent of net worth. Household debt reached a post-World War II high equal to 89 percent of after-tax disposable income compared with 80 percent as the previous high.

Second, as the result of restrictive laws, banks have lost a chunk of their traditional business. This has forced banks to go further out on the risk curve to maintain market share and profit margins.

Third, in a few large banks there is large exposure to LDC debt. While the relative burden is decreasing, many of the large U.S. banks still have significant exposure, especially to Latin American countries. In part, Citibank's recent decision to add $3 billion to reserves reflects this problem. But on this question of portfolio risk, let me reemphasize that while the risk has increased, the capital that is available to cushion potential losses also has increased.

My fourth point deals with the FDIC insurance fund. It is solvent, sound and viable. However, our resources are beginning to show the effects of the unprecedented number of bank closings.

The ratio of reserves to insured deposits is dropping. As of the end of 1986, the reserve declined to $1.12 per $100 of insured deposits, from just under $1.20 a year earlier. Assuming a normal growth rate in insured deposits, and about 200 bank failures this year and, thus, no increase in the fund, the ratio will drop to about $1 per $100 of deposits by year end. This is less than the 1.1 percent ratio below which assessment rebates are precluded. We will be fortunate to keep the reserves at the current level of $18.2 billion at the end of 1987.

We will be immeasurably aided in our endeavors by the recognition of our need to be free of OMB budgetary dictates which is granted us by the Senate banking bill. We thank you, Mr. Chairman, Senator Riegle and members of the committee for recognizing this most important aid to our ability to manage our fund.

Finally, my fifth point is that restructuring of the financial services industry is needed now. The banking system and economic and competitive factors—both national and international—are chang-

ing with unprecedented speed. To date, the response to this evolution has been a hodge-podge of ingenious private sector initiatives that test the limits of existing legal frameworks. The archaic system of laws under which the banking industry operates has created inefficiencies in the system that are contributing to some of the disturbing trends in the banking industry that we are discussing here today.

We believe that long-range financial services restructuring must be undertaken soon. We are aware that the issues are difficult and that the turf to be protected is lucrative. However, the stakes for the stability and competitiveness of our banking system, and thus, our economy is high. We stand ready to assist the Congress in any way we possibly can in this very difficult undertaking.

[The complete prepared statement of L. William Seidman follows:]

TESTIMONY OF

L. WILLIAM SEIDMAN
CHAIRMAN
FEDERAL DEPOSIT INSURANCE CORPORATION
WASHINGTON, D.C.

ON

THE FINANCIAL CONDITION OF FDIC-INSURED INSTITUTIONS

BEFORE THE

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
UNITED STATES SENATE

10 a.m.
May 21, 1987
Room SD-538, Dirksen Senate Office Building

Good morning, Mr. Chairman and members of the Committee. I am pleased to present the FDIC's views on the condition of the banking industry and its insurance fund. At your request, the regulators already have submitted, through the Federal Reserve, a variety of statistics. My testimony today will highlight those statistics by providing the FDIC's overview of the financial condition of FDIC-insured banks. It also will respond to the specific questions raised in your letter of invitation.

The entire financial services industry is undergoing a period of rapid evolution. This evolution is a challenge both to bankers and regulators. It is a challenge as great as any other time in history. Perhaps the hardest job falls to the Congress which has to determine how best to change the laws to respond to these marketplace occurrences. Opinion is divided on what needs to be done. The issues are difficult. The turf to be protected is lucrative. The stakes for the stability and competiveness of our economy are very high. We hope that these hearings will provide information that will assist the Congress in its deliberations. As the repository of the Call Report data for all U.S. banks, the FDIC stands ready to provide data or help in any other way it can. In this connection we call attention to our new Quarterly Banking Profile on the banking system (See Appendix A) which provides the most current information on the banking industry every three months and contains answers to many of the questions raised by this Committee.

FAILED AND PROBLEM BANKS

The condition of the banking system has been better and in a number of areas the trends are adverse. As you are aware, bank failures are at record levels. In 1986, 138 FDIC-insured banks failed and another 7 received financial assistance to avert failure. Unfortunately, we have been setting new records each year, as evidenced by Tables I and II of Appendix B which set forth the number of failed and assisted banks for 1970 through 1986. This year is not expected to be an exception. As of May 15th, there have been 78 failures and 3 assistance transactions, with several other assistance transactions in process. If the current pace continues, we can anticipate at least 200 failures and assistance transactions this year. It should be noted that 87 percent of these failures were West of the Mississippi River and banks in Texas and Oklahoma alone accounted for about half of all bank failures so far this year.

As indicated in Table III of Appendix B, the number of problem banks also is at a record level. As of the end of the first quarter of 1987, there were 1,531 FDIC-insured problem banks with total deposits of $237 billion, up from 1,484 as of year-end 1986 and 1,140 at year-end 1985. Of the 1,531 problem banks, approximately 600 were agricultural banks and 150 were energy banks. Eighty-five percent of the banks on the current problem list are West of the Mississippi River and over 55 percent are in just 6 states. In reviewing the trend in the number of problem banks, it is important to note that there is considerable turnover in the specific banks on the problem list. For example,

in 1986, about 800 banks were added to the list, while around 350 were deleted because of improved condition. The current number of problem banks is a record, but the rate of increase has slowed markedly. In fact, the number in recent months has been relatively stable. We expect the number to increase moderately during the balance of the year. Our guess is that, barring any adverse change in the economy, the number of problem banks will top out in the next year.

As can be seen, the pattern of increases and decreases in the number of problem banks correlates with economic conditions. While much of the country and most sectors of the economy now are experiencing relative prosperity, the differences among areas are much wider than has been experienced historically. The areas West of the Mississippi River, with economies that are largely based on agriculture and energy, have pockets of severe recession or even depression. Most of the FDIC's problem banks today, and in the foreseeable future, are located in these distressed regions. As shown in Table III, the vast majority of problem banks have deposits of under $300 million and most agricultural and energy-sector banks are in this deposit-size category. Our quarterly bank statistics contained in Appendix A indicate clearly the problems by geographic area.

Deficiencies in bank management and policy exacerbate the natural tendency for banks to suffer from weaknesses in the economy. Historically, inept or abusive management has been the primary cause of problem banks. However, the downturn in agriculture and energy has been so severe and protracted that we are past the time when we can simply point to management deficiencies as a

general cause. Today, in the depressed areas of the country, many banks with good records and acceptable management are having financial difficulties. As regulators, we are using new approaches in supervising these institutions.

Traditionally, when bank management was the primary cause of bank difficulties, the FDIC initiated cease-and-desist actions or other formal enforcement procedures. These actions were designed to stop the unsafe and unsound activities and institute corrective measures. They also frequently required the immediate infusion of new equity or new management. This approach was appropriate when management was at fault and is still followed under those circumstances. In fact, enforcement actions against state, non-Federal Reserve members banks totalled 298 in 1985, 241 in 1986 and 75 through April of this year.

We believe that enforcement actions are often counterproductive when management is acceptable, the bank's problems are the result of adverse market conditions, and the prospects for recovery are good, given a reasonable economic cycle. The FDIC seeks to work cooperatively with the management of such banks in a joint effort to restore the financial stability of the banks. The supervisory approach in these circumstances may include meetings with a bank's board of directors, informal agreements in the form of memorandums of understanding or board resolutions detailing the bank's commitments for corrective action and ongoing correspondence with the bank to monitor its progress.

Early last year the FDIC, along with other bank regulators, adopted a formal policy of capital forbearance for banks in the agricultural and energy sectors with severe capital problems. If a bank is granted forbearance, the FDIC will not use its cease-and-desist powers under the Federal Deposit Insurance Act to require immediate restoration of adequate capital. Rather, the bank develops a plan for restoration over a reasonable period of time. Banks qualify for the program if they meet the definition of an agricultural or energy bank, have acceptable management, have capital problems resulting from economic factors, possess sufficient capital to protect against near-term insolvency -- generally considered to be about 3 percent -- and have a business plan that gives promise that the banks can survive. This program has been reasonably successful on a limited basis. As of April 30, 1987, the FDIC had approved 70 of the 154 applications for capital forbearance. Forty applications were denied and the remainder are being reviewed.

We are in the process of improving the effectiveness of the program. We expect to expand the use of capital forbearance beyond agricultural and energy banks to include other economically troubled sectors. Our basic test for forbearance will be geared to the survivability of the institution. If it has a reasonable chance for survival under foreseeable economic conditions then arbitrary benchmarks will be avoided. We expect to modify the program to eliminate fixed capital requirements, to expand it to include any bank that can demonstrate that its problems are primarily attributable to economic problems beyond the control of management and to extend the deadline for admittance.

In addition, the FDIC is considering the feasibility of a program similar to the Net Worth Certificate program used for savings banks under the Garn-St Germain Act. This particular program, however, is in an early stage of consideration and, if instituted, would be used in a limited way for appropriate cases where such use is likely to reduce insurance costs and strains on the banking system.

The thrust of our supervisory efforts is to do whatever we can, consistent with a safe and sound banking system, to limit our insurance losses by permitting viable banks with acceptable management to survive the present period of economic weakness and to recover financial strength once the economy improves. This does not mean that the FDIC intends to allow insolvent banks to continue operations; that every failing bank is viable and should be saved; or that incompetent or abusive management will be tolerated. There will be failures -- unfortunately, many of them -- but we will continue to take reasonable steps to reduce the number of failures and, thus, to lessen the adverse impact on local communities and on our insurance reserves.

GENERAL ECONOMIC CONDITIONS

Before turning to a discussion of the indicators of financial condition, I would like to make some general observations about the economy.

There are indications that the worst of the problems in some parts of the agricultural sector may be over. Land prices have reached levels where, with a reasonable downpayment, farming operations can generate sufficient cash flow

for debt servicing. There is still a lot of available land and equipment depressing the resale market, but those prices may be near the bottom. Thus, while we see little evidence of a rapid upturn, we should see a gradual improvement in the condition of agricultural banks in upcoming years.

The energy economy also seems to have bottomed out, at least in terms of the price of oil. However, the secondary effects of the oil price decline are still working through the economy and the normal lag time between economic decline and a deterioration in the banking community has not yet run its full course.

Are there other economic problems that will affect banks adversely? No one really knows. Real estate of all kinds is a problem in certain areas, often the same areas adversely affected by energy or agriculture. For example, office vacancies and depressed housing values in some major cities in the Southwest are in part a reflection of over-optimism that preceded the energy problems.

On several occasions, I have expressed concern over the level of U.S. private debt -- both consumer and corporate -- much of which is owed to commercial banks. In all sectors of our economy debt is at or near record levels when compared with ability to repay. Overall in our society, there is now about 40 cents more debt for every dollar of income than there was just five years ago. Between 1981 and 1985, corporate debt jumped from 35 percent of net worth to 47 percent. Household debt has reached a post-World War II high

equal to 89 percent of after tax disposable income. Prior to 1985, this ratio had never even reached 80 percent. Recent estimates are that debt service absorbs nearly a third of monthly household income and, for many families, more than half. I would be more comfortable if household and business debt levels could be returned to more normal levels.

No one knows how much private debt the economy prudently can carry. It seems obvious, however, that the higher the debt when compared with ability to repay, the worse the effects of any economic downturn are likely to be -- especially for the banking industry. While there is little indication of a near-term recession, our present recovery has gone on for an extended period by historical standards and based on history will not last indefinitely.

FINANCIAL CONDITION OF THE INDUSTRY

With problem and failed banks at record levels, it is important to maintain overall perspective. Approximately 90 percent of insured banks are not considered problems and failures last year represented only about 1 percent of the total number of banks. Indicators of the health of the banking industry are mixed, as demonstrated by the selected performance and condition indicators from our Quarterly Banking Profile. Overall the statistics show a reasonably sound industry, but the averages mask a number of problems.

Capital - The banking system as a whole seems to be maintaining adequate capital. As shown in Table IV of Appendix B, aggregate primary capital of all insured banks at year-end 1986 was $211 billion. This represents an increase

of $82 billion over 1981 when specific minimum capital ratios first were mandated by the federal bank regulators. The aggregate equity capital of these institutions increased by $65 billion during the same period. The ratio of capital to assets -- the traditional measure of adequacy -- is higher among small banks than large banks, but aggregate capital of banks in all size categories exceeds the minimum ratio even with over 1,500 problem banks.

There has been considerable concern regarding banks' exposure to off-balance sheet risk. This is one of the primary factors behind the regulators' recent proposal for a risk-based system of capital analysis. Though the assessment of capital adequacy may be affected by the information received as a result of this proposal, the FDIC does not now have evidence indicating that the system as a whole is in need of substantial increases in capital. However, individual institutions may be required to increase capital. We strongly support bringing off-balance sheet activity into better focus through improved reporting and accounting techniques. This will enable regulators, as well as private industry analysts, to better and more consistently evaluate levels of capital adequacy.

Some of what has appeared as new equity capital in banks may be the result of so called double-leveraging by holding companies -- defined as equity investments in subsidiaries as a percent of the holding company equity. This occurs when the parent company incurs debt and uses the proceeds to purchase equity in its subsidiary bank(s). Double-leveraging can be a cause for concern. Since the normal practice is to service this debt through dividends from the banks, excessive payments can be a threat to the banks in the holding

company. The FDIC analyzes double-leveraging, as well as other parent company information, on a case-by-case basis during the examination of individual banks. We have seen a number of examples of bank holding company leveraging for purchases of bank stock that have weakened the banks in the system. This is particularly evident in unit banking states such as Oklahoma and Texas. Note the difference in double-leveraging by region as indicated in Table V in Appendix B.

In addition to double leverage, many owners of independent banks also rely on loans to finance their stock purchases. Thus, the amount of tangible, nonfinanced bank equity is much less than the apparent capital in a number of states.

Earnings - If the level of bank capital is to remain adequate, banks must prosper. They must be sufficiently profitable to retain enough earnings to maintain capital and to make the bank's stock attractive to investors. Table VI of Appendix B indicates that on the average bank earnings have been declining. However, this kind of averaging can be misleading since it is heavily weighted by the significantly poorer results of small banks west of the Mississippi. (See the chart "Return on Average Assets, East vs. West" in our Quarterly Banking Profile.) Return on equity in 1986 averaged 8.75 percent and return on assets 0.74 percent for insured commercial banks. This compares to levels five years ago of roughly 13 percent and 1 percent, respectively. Moreover, in 1986, nonrecurring items and gains from the sale of securities amounted to nearly 25 percent of the total net income for insured commercial banks.

Early results for the first quarter of 1987 indicate that earnings deterioration is continuing. The aggregate net income of the 26 largest bank holding companies was down 16 percent or $342 million in the first quarter of 1987 when compared to the first quarter of 1986. The drop can be attributed in large part to the placement of large amounts of loans to Brazil into nonaccrual status. Even without the effect of the loans to Brazil, there was a decline in earnings, partially attributable to shrinking interest margins.

The earnings for smaller banks continue under pressure from high levels of loan losses and nonperforming assets. Preliminary data indicate that about 15.5 percent of banks under $100 million in assets lost money in the first quarter of 1987 or about the same as last year. Of the banks in the $100 million to $1 billion category, between 7 percent and 10 percent had losses. For the first quarter last year, 6.5 percent of these banks were unprofitable.

There have been a variety of developments in recent years that make satisfactory earnings more difficult to achieve. Among these are the poor economic conditions in certain parts of the country, an increasing tendency of the largest most creditworthy commercial loan customers to bypass banks and access credit markets directly, and intensified competition for both loan and deposit customers from nontraditional banking businesses. In addition, bank earnings will be affected adversely by recent tax reform. In the face of increasing credit problems, the elimination of the deduction for, and the recapture of, bad debt reserves is particularly unfortunate.

Banks have been creative in developing new products and services to combat these pressures. Assets are being securitized and sold rather than held in portfolios -- a practice which frees up capital. Significant fee income now is generated by letters of credit and the swap market -- which have grown from little or nothing to billions of dollars in a very short time. As of year-end 1986, letters of credit and loan commitments alone amounted to $750 billion. Despite these efforts, however, as evidenced by the statistics in Table VI, the profitability of banking appears to be declining.

Banks located in markets with limited opportunities for diversification have fared worse than the norm. The problems of agriculture, energy and real estate already have been discussed. Banks serving these markets are having a difficult time. In fact, there were six states in 1986 -- Oklahoma, Texas, Wyoming, Montana, Louisiana and Alaska -- in which the banking industry in the aggregate lost money.

The FDIC believes that if the banking system is to remain adequately profitable it must be allowed to pursue profit opportunities throughout the financial services industry. We believe these opportunities can be pursued in a manner that is consistent with safety and soundness considerations if appropriate safety surveillance is provided by the regulators.

Asset Quality - One of the results of the changing competitive climate has been a marked increase in the volume of problem loans and loan charge-offs. As noted in our Quarterly Banking Profile, net charge-offs to loans have increased steadily from 0.56 percent in 1982 to 0.99 percent in 1986. Despite

this increase, nonperforming assets continue to remain high at 1.96 percent. As additional proof of deteriorating loan quality, FDIC losses on failed banks have risen substantially to over 22 percent of total bank assets. These increased losses reflect the larger percentage of poor quality loans in failed banks.

As you would expect, the asset quality problem is most pronounced in depressed economic areas but, to a lesser degree, is reflected in the industry as a whole. The major recognized problem areas are agriculture, energy, real estate and LDC debt. While the agricultural and energy problems are common to many banks, LDC debt is concentrated in a small number of institutions. Nine money-center banks recently accounted for 60 percent of the U.S. banking system's exposure to foreign debt and 65 percent of the exposure to Latin American debt. However, Latin American debt, as a percent of primary capital at the nine money-center banks, has declined from 180 percent in 1982 to 100 percent in September 1986.

Even outside the recognized problem lending areas it appears that banks, overall, have had to accept greater loan risk in order to maintain earnings and loan volume. It seems clear that the risk in the system has been increased by deteriorating loan portfolio quality. Limiting the losses that result from this increased risk will be necessary to insure banks' future profitability.

Liquidity - Although one of the most important areas of banking, liquidity is the most difficult to measure and the area most subject to rapid change.

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Currently, liquidity throughout the system would appear to be adequate judged by the satisfactory performance in recent years despite adverse economic conditions. But interest rates have been relatively low and funds plentiful. Though individual cases can be found where brokered deposits perhaps have increased the risk assumed by the FDIC in failing banks, experience has shown that brokered deposits are not the problem that they were a few years ago. As of year-end 1986, brokered deposits held by reporting banks totalled $6.2 billion compared to $17.9 billion at year-end 1984. Developments such as securitization and broadened secondary markets which were not previously available now also provide liquidity for many types of assets. Liquidity, however, is a creature of economic circumstance in which confidence is of the utmost importance. If a recession occurred or if interest rates rose and money became tight, today's favorable liquidity position could change markedly, particularly for our savings banks.

FDIC SUPERVISION

FDIC supervision is directed toward maintaining the safety and soundness of the banking system and protecting the insurance fund against unnecessary loss. Much of our resources are now focused on marginal or problem banks. The FDIC has a workload that is probably greater, and a role in the smooth operation of our financial system that is more important, than at any other time since the agency was created.

The FDIC currently employs 1,744 field bank examiners. As indicated in Table VII of Appendix B, this number is up sharply from recent figures, but is

low relative to the number of examiners we employed in 1978. In that year our field examination force reached a record high of 1,760 examiners, with 342 problem banks and 7 bank failures. In contrast, as previously stated, currently there are over 1,500 problem banks and a possibility of 200 or more failures in 1987. As indicated, only 1,744 FDIC examiners are employed to handle this significantly more formidable environment. It is clear that our present number of examiners is insufficient to deal with our responsibilities and the current level of problems in the bank system.

We estimate a force of at least 2100 examiners will be necessary to achieve an acceptable examination frequency and scope. Our goal is to conduct a safety and soundness examination of satisfactory banks (CAMEL ratings of 1 or 2) once every three years, marginal banks (CAMEL 3) every 18 months and problem banks (CAMEL 4 or 5) every year. Currently, we are averaging once every four years for satisfactory banks, once every two years for marginal banks and about once every 19 months for problem banks.

Some of our regions are more behind schedule than others. In our Southwest region, for example, we examined only 11 percent of the 1 and 2 rated banks last year. The pressures on our work force also have caused us to fall behind in specialized exams such as those covering consumer compliance and trust department operations.

Beginning in 1978, the FDIC purposely reduced its number of examiners. We believed that our regulatory responsibilities could be accomplished with less of the traditional onsite examination, especially in satisfactorily rated

banks. To supplement our reduced examination efforts, we used increased offsite surveillance, brief visitations, reliance on state regulators where appropriate, and increased market discipline. Though this effort was successful in the "old" banking industry, conditions have changed. We are not able to maintain even our more liberal examination schedule at the present time. Therefore, we have increased our staff and intend to continue to do so subject only to budgetary constraints.

We are in the process of trying to increase the field staff by about 350 employees during the next year. Because of the training period involved for new employees, there is and will continue to be a considerable strain on our experienced examiners in many parts of the country. To alleviate this strain, the FDIC is experimenting with supplementing our examination force with experienced certified public accountants who are hired on a per diem basis to assist our examiners in specific examinations. Early indications are that this experiment will be reasonably successful and some help can be furnished by this plan.

The current period is the most challenging and the need for effective safety and soundness supervision (not increased regulation) the greatest in the FDIC's history. We must adapt to a greater number of changes more quickly than ever before. Flexibility, creativity and innovation are absolutely essential if the FDIC is to continue to be effective in its critical role.

In the face of this environment, and after 36 years of precedent to the contrary, the Office of Management and Budget has asserted new and, we

believe, unfounded jurisdiction over the FDIC. We applaud the Chairman, the members of this Committee and the Senate for including in the banking bill a provision expressly excluding the federal bank regulators from the apportionment provisions of the Anti-Deficiency Act. I would like to reemphasize the importance of that legislation to the effective operation of the Corporation.

ADEQUACY OF THE FDIC FUND

The FDIC insurance fund presently stands at about $18.2 billion and is adequate to handle foreseeable problems in the banking system. The fund, however, is beginning to show some effects from the unprecedented number of bank failures. Our ratio of reserves to insured deposits is declining. As of year-end 1986, the reserve slipped to $1.12 per $100 of insured deposits, from just under $1.20 a year earlier. Insured deposits grew about 8.7 percent last year. If we project a similar growth rate for 1987 and assume no growth in the $18.2 billion fund, then the projected ratio of the fund to insured deposits will drop to about 1 percent. Under the Federal Deposit Insurance Act, when the ratio of the fund to insured deposits is below 1.1 percent, the FDIC may not provide assessment rebates to insured banks.

Although the total reserves of the FDIC have increased every year, bank failures are absorbing substantially all of our current income. In 1986 the fund grew by less than $300 million in the wake of 145 bank failures or assisted transactions. With the prospect of 200 or more bank failures in 1987, we will have difficulty breaking even in 1987. We are confident that

our financial resources are adequate for our present responsibilities, but insuring substantial amounts of deposits that now are FSLIC-insured certainly would stretch our reserves. Our estimates are that as many as 1,000 thrifts, with deposits of $184 billion, could meet FDIC capital requirements and have acceptable earnings. If all those institutions converted to FDIC insurance, our projected reserves to insured deposits ratio would decline by over 10 percent.

CONCLUSION

To conclude, I would like to underscore some of my opening remarks. Banking is experiencing and will continue to experience rapid and critical changes. Currently, the government's presence is a hodgepodge of state, regulatory and court rulings. This mixture, combined with ingenious private sector initiatives, has resulted in an inefficient and archaic system. Long-range banking industry restructuring is overdue and should be undertaken to improve competitiveness, reduce regulatory costs and provide increased safety and soundness for the financial system. The FDIC believes action is needed and we will be happy to cooperate with you in any way we can to help achieve it.

Thank you. I will be pleased to respond to any questions.

FDIC
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APPENDIX A

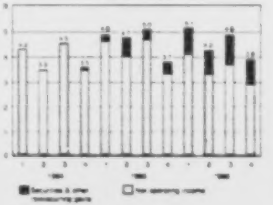
Quarterly Banking Profile

FEDERAL DEPOSIT INSURANCE CORPORATION — L. William Seidman, Chairman

COMMERCIAL BANKING PERFORMANCE — FOURTH QUARTER, 1986

Commercial banks' net income totalled $17.8 billion in 1986, down 1.4 percent from the record $18.1 billion reported in 1985, but still the second highest total ever reported, according to preliminary data. Fourth-quarter net income was $3.8 billion, up 7.7 percent from the fourth quarter a year ago. Net operating earnings were down 16.3 percent in 1986, despite earning asset growth of nearly 8 percent. For the full year, nonrecurring items and gains from the sale of securities amounted to $4.2 billion, or nearly one-fourth of bottom-line net income.

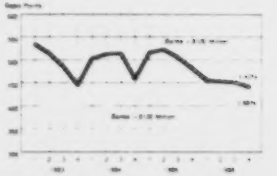
Quarterly Net Income of FDIC-Insured Commercial Banks 1984—1986



During 1986, total bank assets, loans, deposits and equity capital grew at almost identical rates. Weak loan demand and lower interest rates caused banks to adjust the composition of their balance sheets. The need to increase high-yielding assets prompted them to lengthen maturities in investment securities portfolios and to emphasize mortgage and consumer lending. While total loans grew 7.6 percent, real estate loans expanded a robust 17.2 percent and consumer loans increased 8.6 percent. Commercial and industrial loans, in contrast, grew only 4.0 percent, reflecting softness in demand and heightened nonbank competition.

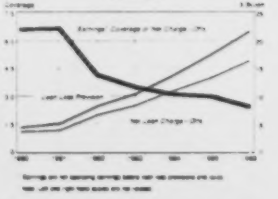
Falling interest rates also contributed to year-to-year reductions in both interest income and expense. Net

Commercial Bank Net Interest Margins 1983—1986



interest margins, which contracted 13 basis points for the year, were hurt by the 12.8 percent growth of nonperforming assets. Noninterest income made a larger contribution to earnings in 1986, growing nearly 16 percent. Noninterest expense grew roughly in line with assets, and as a result, net noninterest expense declined to 1.85 percent of assets from 1.98 percent in 1985. Most of this improvement was centered in the largest banks.

Loan-Loss Expense, Net Loan Charge-Offs and Earnings Coverage of Loan Losses 1980—1986



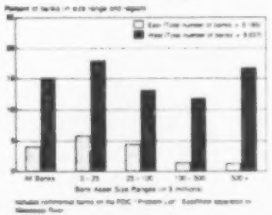
Banks' loan-loss expense continued to be a drag on earnings. Provisions totalled $21.7 billion in 1986, up over $4 billion from year-ago levels — a 22.7 percent increase. They covered $16.3 billion in net loan

charge-offs, and still boosted loss reserves 23.6 percent during 1986. At year-end, the ratio of loss reserves to nonperforming assets stood at 50 percent, compared with 45 percent a year ago. Nonperforming assets ended the year at 1.96 percent of total assets, up from 1.87 percent in 1985.

The number of banks reporting losses (net income less than zero) in 1986 climbed to 2,784, or nearly 20 percent of all insured commercial banks, compared with 2,453 in 1985. In the fourth quarter, 4,354 banks reported a net loss, down from 4,395 in the same period of 1985. It should be noted that quarterly income and loss figures are affected by the fact that many banks concentrate loan loss provisions in the fourth quarter of each year.

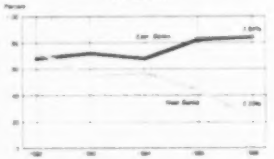
Most (81.4 percent) of the unprofitable banks in 1986 were located west of the Mississippi. In general, banks in the eastern part of the U.S. have had better asset growth, better credit quality, higher profitability and fewer problem institutions or failures than their western counterparts. The influences of agricultural problems on smaller banks and energy-related problems on small and large banks in the west account for much of these differences.

Distribution of Problem Banks by Asset Size and Region



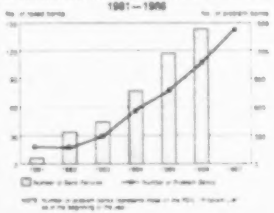
Banks in all three regions in the western half of the nation have seen their income reduced by exceptionally high loan losses. In the West region, these losses have centered around real estate and energy-related credits; banks in the Midwest region have been squeezed by losses stemming from depressed farm prices. The Southwest region has also had sizable losses associated with commercial real estate and agricultural problems, but loans to the energy sector have had the greatest negative impact. Despite the highest charge-off rate of any region in 1986, Southwest banks still were left with the highest level of nonperforming assets — over four percent of total assets — at year-end. Sixty-two of the 144 commercial banks that failed or received assistance in 1986 were in the Southwest. The region also had the highest proportion of unprofitable banks in 1986 — 35 percent — while the West region had the largest share of banks on the "problem" list. The Southeast, Northeast and Central regions had the fewest troubled institutions, and showed improving trends in this area.

Return on Average Assets, East vs. West 1982—1986



Continued growth in the number of "problem" banks, up 33 percent over 1985's level to 1,457 at year-end, suggests 1987 will see another substantial increase in the number of bank failures. For the banking industry, 1987 is likely to be marked by continued credit-quality problems among commercial and real estate loans stemming from lingering weakness in the agricultural and energy sectors. Beyond the domestic portfolio, uncertainty has increased regarding LDC loans, although the level of exposure from these loans has fallen relative to bank capital.

Numbers of Problem and Failed Commercial Banks 1981—1986



Deteriorating domestic credit quality in general, as well as uncertainties surrounding LDC loan exposure, call for a guarded earnings outlook for 1987. It should be noted, however, that the banking industry has continued to augment its capital position. During 1986, total primary capital increased by 9.2 percent to $208 billion, the highest level ever. The ratio of primary capital to assets now stands at 7.04 percent, up from 6.97 percent a year ago.

U.S. COMMERCIAL BANKING INDUSTRY QUARTERLY PROFILE
Aggregate Condition and Income Data, FDIC-Insured Commercial Banks *(dollar figures in millions)*

	Preliminary 4th Qtr 1986	3rd Qtr 1986	4th Qtr 1985	% Change 85-86
Number of banks reporting	14,181	14,306	14,494	-1.5
Total employees (full-time equivalent)	1,562,430	1,566,231	1,561,696	0.0
CONDITION DATA				
Total Assets	$2,936,400	$2,901,895	$2,730,498	7.5
Real estate loans	514,001	486,839	438,426	17.2
Commercial & industrial loans	600,871	572,084	571,738	5.0
Loans to individuals	335,441	326,102	308,930	8.6
Farm loans	31,988	34,204	36,107	-11.4
Other loans and leases	272,750	263,913	269,581	1.2
Total loans and leases	1,754,749	1,683,142	1,630,782	7.6
LESS: Reserve for losses	26,701	27,252	23,216	23.6
Net loans and leases	1,728,048	1,655,890	1,607,566	7.4
Temporary investments	463,844	492,868	461,730	2.6
Securities over 1 year	357,240	343,153	303,381	21.1
All other assets	381,459	391,913	357,851	3.7
Total liabilities and capital	$2,936,400	$2,901,895	$2,730,498	7.5
Noninterest-bearing deposits	532,211	446,565	471,340	12.9
Interest-bearing deposits	1,745,603	1,713,022	1,646,435	6.2
Other borrowed funds	358,600	339,243	320,369	12.0
Subordinated debt	16,888	16,580	14,699	15.2
All other liabilities	90,394	107,012	108,497	-16.7
Equity capital	192,486	179,523	169,200	7.9
Nonperforming assets	57,538	58,749	51,095	12.6
Loan commitments and letters of credit	750,905	745,687	739,548	3.1
Domestic office assets	2,529,385	2,388,749	2,335,024	8.8
Foreign office assets	406,015	513,136	405,474	0.9
Domestic office deposits	1,987,019	1,894,917	1,781,832	9.5
Foreign office deposits	313,795	324,760	321,244	-2.5

INCOME DATA	Preliminary Full Year 1986	Full Year 1985	% Change	Preliminary 4th Qtr 1986	4th Qtr 1985	% Change
Total interest income	$227,681	$248,210	-8.3	$57,995	$62,479	-7.2
Total interest expense	142,691	157,309	-9.3	33,451	38,758	-13.7
Net interest income	84,970	90,910	-6.5	24,554	23,721	3.5
Provisions for loan losses	21,739	17,717	22.7	6,621	6,148	7.7
Total noninterest income	36,886	31,937	15.5	9,834	8,702	13.0
Total noninterest expense	80,594	68,338	9.4	24,352	22,161	8.5
Application income taxes	5,397	5,944	-4.4	384	856	-42.2
Net operating income	13,610	16,268	-16.3	2,811	3,157	-11.0
Securities gains, net	3,837	1,587	152.6	944	386	144.6
Extraordinary gains, net	270	224	20.5	97	-3	3240.0
Net income	17,827	18,087	-1.4	3,810	3,536	7.7
Net charge-offs	15,342	13,246	23.4	5,333	4,844	6.2
Net additions to capital stock	3,152	2,386	33.3	2,205	1,651	33.8
Cash dividends on capital stock	8,206	8,529	6.0	1,838	2,044	13.4

Selected Performance and Condition Indicators, FDIC-Insured Commercial Banks

	1982	1983	1984	1985	1986
Return on assets	0.71%	0.68%	0.68%	0.76%	0.64%
Return on equity	12.11	10.76	10.73	11.31	10.10
Equity capital to assets	5.87	6.33	6.18	6.80	6.71
Nonperforming assets to assets	1.85	1.97	1.97	1.87	1.96
Net charge-offs to loans	0.59	0.67	0.76	0.84	0.96
Asset growth rate	8.12	8.75	7.11	9.48	7.57
Net operating income growth	-0.62	-3.69	3.45	6.30	-16.32
Number of unprofitable banks	1,763	1,530	1,891	2,453	2,784
Number of problem banks	338	668	800	1,098	1,457
Number of failed banks	34	48	79	118	144

Preliminary Bank Data and Performance and Condition Ratios.
Distributed by Asset Size and by Region, Fourth Quarter 1988 *(Dollar figures in billions, ratios in %)*

		Asset Size Distribution						Geographic Distribution					
								EAST				WEST	
	All Banks	Less than $25 Million	$25-100 Million	$100-300 Million	$300-1000 Million	$1-10 Billion	Greater than $10 Billion	Northeast Region	Southeast Region	Central Region	Midwest Region	Southwest Region	West Region
Number of banks reporting	14,181	4,813	6,591	1,936	543	306	12	990	1,850	3,122	3,315	3,135	1,679
Total assets	$3,938.4	$77.3	$323.5	$309.4	$276.2	$957.9	$1,992.4	$1,112.4	$486.7	$463.6	$295.1	$301.7	$453.9
Total deposits	2,867.7	62.1	268.9	256.7	232.3	668.8	1,378.9	826.2	354.2	375.9	190.1	246.2	175.1
% of total banks	100.0%	33.9%	46.4%	13.6%	3.8%	2.2%	0.2%	7.0%	13.0%	22.0%	23.4%	22.1%	11.8%
Asset share (%)	100.0	2.0	8.2	7.9	7.0	24.3	50.6	28.2	12.4	11.8	7.5	7.7	11.5
Deposit share (%)	100.0	2.2	9.4	9.0	8.1	23.3	48.1	28.8	12.4	13.1	6.6	8.6	6.1
Number of unprofitable banks	4,059	2,002	1,614	307	70	47	0	119	411	979	1,172	1,010	348
Number of failed banks	37	16	17	1	1	0	0	0	1	0	11	17	8
Performance ratios (annualized)													
Yield on earning assets	9.38%	10.10%	9.62%	9.66%	10.12%	9.11%	9.14%	9.15%	9.62%	9.20%	9.83%	9.62%	9.62%
Cost of funding earning assets	5.44	5.47	5.46	5.32	5.48	5.30	5.77	5.54	5.47	5.37	5.69	5.57	5.15
Net interest margin	3.94	4.63	4.31	4.37	4.63	4.03	3.37	3.61	4.47	3.83	4.27	4.05	4.47
Net noninterest expense to earning assets	2.31	3.66	2.89	2.73	2.81	2.32	1.73	1.92	2.79	2.28	2.63	2.60	2.92
Net operating income to assets	0.40	-0.66	-0.00	0.33	0.25	0.59	0.46	0.54	0.58	0.65	0.46	0.30	0.32
Return on assets	0.54	-0.48	0.17	0.47	0.42	0.72	0.63	0.76	0.68	0.74	0.63	0.54	0.42
Return on equity	6.48	-4.89	2.04	6.27	6.09	11.86	12.68	12.69	10.19	10.71	8.69	10.67	7.39
Net charge-offs to loans and leases	1.24	0.84	0.84	1.02	1.02	1.45	1.39	0.74	0.90	0.46	0.46	0.26	1.37
Condition Ratios													
Loss reserve to loans and leases	1.99%	1.76%	1.53%	1.46%	1.58%	1.46%	1.83%	1.46%	1.20%	1.44%	1.81%	2.01%	1.82%
Nonperforming assets to assets	1.85	2.60	2.17	1.88	1.90	1.48	2.29	1.54	1.12	1.30	2.02	4.06	2.09
Equity capital ratio	6.21	6.59	6.16	7.28	6.74	5.96	5.14	5.81	6.57	6.90	7.15	6.46	5.68
Primary capital ratio	7.04	10.42	8.91	7.97	7.51	6.60	6.19	6.58	7.07	7.52	8.11	7.69	6.74
Net loans and leases to assets	59.74	48.20	50.49	54.45	59.35	65.45	61.59	59.62	57.59	58.15	51.58	55.45	63.56
Net assets repricable in one year or less to assets	5.14	5.28	7.25	4.90	4.52	3.75	4.87	4.20	5.25	3.46	10.46	4.32	2.28
Growth Rates (from year ago quarter)													
Assets	7.5%	5.3%	8.0%	10.8%	12.6%	10.2%	6.7%	11.9%	10.2%	9.2%	14.4%	3.6%	5.0%
Earning assets	7.8	6.4	7.9	10.5	12.2	10.1	7.4	12.8	10.6	8.7	14.6	3.9	5.1
Loans and leases	7.6	4.1	5.0	9.1	13.7	14.1	7.3	13.5	10.6	9.9	11.5	4.5	10.2
Loss reserve	23.6	15.3	17.2	23.3	31.7	30.4	29.0	24.2	22.2	15.6	33.0	44.0	35.7
Net charge-offs	5.2	2.1	1.9	21.9	45.6	34.2	2.3	25.3	15.4	4.0	1.3	29.2	10.4
Nonperforming assets	12.6	14.2	15.9	16.5	33.4	18.0	16.5	11.4	20.3	4.4	4.7	57.1	18.5
Deposits	7.6	7.2	6.6	11.4	13.6	15.8	6.9	13.0	16.7	9.1	12.5	0.1	10.2
Equity capital	7.9	0.5	5.4	6.1	10.7	15.0	10.2	14.5	17.9	9.2	16.1	4.1	12.4
Interest income	7.1	6.2	5.4	2.8	5.3	5.2	11.5	5.6	7.4	4.6	9.4	15.4	10.8
Interest expense	13.7	10.2	9.1	7.4	4.3	7.5	17.2	13.3	6.2	12.0	12.7	16.1	19.0
Net interest income	2.0	4.7	4.0	3.6	9.4	11.8	0.5	6.5	9.0	2.6	4.6	10.1	0.6
Loan loss expense	7.7	19.3	9.7	20.1	33.5	33.6	12.5	42.4	2.3	8.5	17.9	28.5	4.9
Noninterest income	13.0	9.2	7.9	10.9	19.7	6.3	20.9	11.9	9.6	10.9	42.6	4.2	15.8
Noninterest expense	8.5	2.9	5.3	8.2	14.1	14.1	13.4	13.1	9.6	9.5	8.0	3.4	9.1
Net operating income	11.0	19.0	84.0	22.7	-51.3	15.0	17.6	4.8	-7.7	4.9	84.0	317.2	448.1
Net income	7.7	32.2	3.9	-17.3	-33.8	-3.1	31.8	8.5	16.1	6.5	126.0	167.2	27.1

REGIONS: Northeast — Connecticut, Delaware, District of Columbia, Maine, Maryland, Massachusetts, New Hampshire, New Jersey, New York, Pennsylvania, Puerto Rico, Rhode Island, Vermont
Southeast — Alabama, Florida, Georgia, Mississippi, North Carolina, South Carolina, Tennessee, Virginia, West Virginia
Central — Illinois, Indiana, Kentucky, Michigan, Ohio, Wisconsin
Midwest — Iowa, Kansas, Minnesota, Missouri, Nebraska, North Dakota, South Dakota
Southwest — Arkansas, Louisiana, New Mexico, Oklahoma, Texas
West — Alaska, Arizona, California, Colorado, Hawaii, Idaho, Montana, Nevada, Oregon, Pacific Islands, Utah, Washington, Wyoming

NOTES TO USERS

Computation Methodology for Performance and Condition Ratios

All income figures used in calculating performance ratios represent amounts for that quarter, annualized.

All asset and liability figures used in calculating performance ratios represent average amounts (beginning of period amount plus end-of-period amount, divided by two).

All asset and liability figures used in calculating the condition ratios represent amounts as of the end of the period.

Definitions

"Problem" Banks — Federal regulators assign to each financial institution a uniform composite rating, based upon an evaluation of financial and operational criteria. The rating is based on a scale of 1 to 5 in ascending order of supervisory concern. "Problem" banks are those institutions with financial, operational or management weaknesses that threaten their continued financial viability. Depending upon the degree of risk and supervisory concern, they are rated either "4" or "5".

Earning Assets — all loans and other investments that earn interest, dividend or fee income.

Yield on Earning Assets — total interest, dividend and fee income earned on loans and investments as a percentage of average earning assets.

Cost of Funding Earning Assets — total interest expense paid on deposits and other borrowed money as a percentage of average earning assets.

Net Interest Margin — the difference between the yield on earning assets and the cost of funding them, i.e., the profit margin a bank earns on its loans and investments.

Net Noninterest Expense — total noninterest expense, excluding the expense of providing for loan losses, less total noninterest income. A measure of banks' overhead costs.

Net Operating Income — income after taxes but before gains (or losses) from securities transactions and nonrecurring items. The profit earned on banks' regular banking business.

Return on Assets — net income (including securities transactions and nonrecurring items) as a percentage of average total assets. A basic yardstick of bank profitability.

Return on Equity — net income as a percentage of average total equity capital.

Net Charge-offs — total loans and leases charged off (due to uncollectibility), less amounts recovered on previous charge-offs.

Nonperforming Assets — the sum of loans past-due 90 days or more, loans in nonaccrual status and real estate owned (other than bank premises).

Primary Capital — total equity capital plus the allowance for loan and lease losses, plus minority interests in consolidated subsidiaries, plus qualifying mandatory convertible debt, less intangible assets (except purchased mortgage servicing rights).

Net Loans and Leases — total loans and leases, less unearned income and the allowance for loan and lease losses.

Net Assets Repriceable in One Year or Less — short-term and variable rate interest-earning assets, minus interest-bearing liabilities maturing or repriceable within the same one-year interval. A measure of banks' sensitivity to interest rate changes, where a positive value indicates that banks' income from assets is more sensitive to movements in interest rates than is the expense of their liabilities, and vice-versa for a negative value.

Temporary Investments — the sum of interest-bearing balances due from depository institutions, federal funds sold and resold, trading account assets and investment securities with remaining maturities of one year or less. These are banks' more liquid investments.

Loan Loss Expense — the addition to the allowance for loan and lease losses, the reserve maintained to absorb expected loan losses.

Additional information regarding bank performance, bank failures and economic issues affecting the banking industry is available in the *Banking and Economic Review*, published by the Division of Research and Strategic Planning, FDIC. Information on legislative issues and changes in state and federal laws and regulations governing banks is contained in the *Regulatory Review*, also published by the Division of Research and Strategic Planning. Single-copy subscriptions are available to the public free of charge. Requests should be mailed to:

Banking and Economic Review or *Regulatory Review*
Division of Research and Strategic Planning
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, DC 20429

APPENDIX B

TABLE I

FDIC-INSURED CLOSED BANKS

YEAR-END	0 - $300* MILLION		$300 - $1,000 MILLION		OVER $1 BILLION		TOTAL	
	#	TOTAL ASSETS**	#	TOTAL ASSETS	#	TOTAL ASSETS	#	TOTAL ASSETS
1986	135	4,287,971	2	1,061,013	1	1,616,816	138	6,965,800
1985	116	2,851,969					116	2,851,969
1984	78	2,371,211	1	391,800			79	2,763,011
1983	43	1,954,397	1	778,434	1	1,404,092	45	4,136,923
1982	30	1,530,573	2	962,842			32	2,493,415
1981	7	260,060					7	260,060
1980	10	236,164					10	236,164
1979	10	132,988					10	132,988
1978	6	281,495	1	712,540			7	994,035
1977	6	232,612					6	232,612
1976	15	627,186	1	$412,107			16	1,039,293
1975	13	419,950					13	419,950
1974	3	166,934			1	3,655,662	4	3,822,596
1973	5	43,807			1	$1,265,868	6	1,309,675
1972	1	22,054					1	22,054
1971	6	196,520					6	196,520
1970	7	$62,147					7	$62,147

* CATEGORIES ARE BY ASSET SIZE.

** 000 OMITTED FROM "TOTAL ASSETS" FIGURES.

TABLE II

FDIC-INSURED OPEN BANKS WHICH RECEIVED FINANCIAL ASSISTANCE

YEAR-END	UNDER $300* MILLION		$300 - $1,000 MILLION		OVER $1 BILLION		TOTAL	
	#	TOTAL ASSETS**	#	TOTAL ASSETS	#	TOTAL ASSETS	#	TOTAL ASSETS
1986	6	220,694	1	500,000			7	720,694
1985	2	197,879	1	492,420	1	5,200,000	4	5,890,299
1984			1	513,400	1	35,900,000	2	36,413,400
1983	2	390,000			1	2,500,000	3	2,890,000
1982	2	206,000	5	3,533,000	3	5,400,000	10	9,139,000
1981			1	899,000	2	3,700,000	3	4,599,000
1980					1	5,500,000	1	5,500,000
1979								
1978								
1977								
1976			1	$350,000			1	350,000
1975								
1974	1	150,000					1	150,000
1973								
1972					1	$1,300,000	1	1,300,000
1971	1	$9,300					1	$9,300
1970								

* CATEGORIES ARE BY ASSET SIZE.

** 000 OMITTED FROM "TOTAL ASSETS" FIGURES.

TABLE III

FDIC-Insured Problem Banks-
Total Deposits by year

Year-End	0 - $300 Million		$300 - $1,000 Million		Over $1 Billion		Total	
	#	Deposits	#	Deposits	#	Deposits	#	Deposits
1986	1,412	$54,915	46	$24,348	26	$191,683	484	$270,946
1985	1,069	41,317	41	23,217	30	132,593	1,140	197,127
1984	778	31,031	38	20,129	32	134,949	848	186,109
1983	591	26,828	31	16,513	20	85,740	642	129,081
1982	332	12,759	21	10,119	16	34,460	369	57,338
1981	197	5,659	15	9,423	11	27,482	223	42,564
1980	206	4,599	7	4,860	4	12,185	217	21,644
1979	274	6,995	11	6,559	2	6,763	287	20,317
1978	322	8,404	14	7,668	6	48,069	342	64,142
1977	348	10,036	13	7,307	7	44,561	368	61,904
1976	361	11,286	10	6,037	8	41,830	379	59,153
1975	340	9,971	7	3,955	2	6,517	349	20,443
1974	177	4,525	5	3,116	1	1,420	183	9,061
1973	154	3,107	2	1,499	0	0	156	4,036
1972	189	3,141	3	2,192	0	0	192	5,333
1971	239	3,504	2	1,453	0	0	241	4,957
1970	251	3,613	0	0	1	1,076	252	4,689

- CAMEL ratings of 4 and 5 and pre-CAMEL equivalents
- Categories are by asset size
- Deposit amounts are shown in $Million

TABLE IV

CAPITALIZATION DATA*
FDIC-INSURED COMMERCIAL BANKS, 1981-1986
(DOLLAR VALUES IN BILLIONS)

	1986	1985	1984	1983	1982	1981
EQUITY CAPITAL	$183	$169	$154	$140	$129	$118
PRIMARY CAPITAL**	$211	$192	$173	$156	$142	$129
EQUITY CAPITAL RATIO	8.18%	8.42%	8.42%	8.47%	8.52%	8.51%
PRIMARY CAPITAL RATIO	9.10%	9.20%	9.16%	9.04%	9.03%	9.04%

* INFORMATION OBTAINED FROM THE UNIFORM BANK PERFORMANCE REPORTING SYSTEM. RATIOS REPRESENT THE UNWEIGHTED AVERAGE OF THE RATIO VALUE OF EACH INSURED COMMERCIAL BANK.

** EQUITY CAPITAL PLUS ALLOWANCE FOR LOAN LOSSES.

TABLE V

BANK HOLDING COMPANY
DOUBLE LEVERAGE RATIOS*
BY REGION, DECEMBER 31, 1985

REGION	ALL BHC'S	BHC'S UNDER $10 MILLION
NORTHEAST	99.8%	99.9%
SOUTHEAST	107.4	99.7
CENTRAL	109.8	157.9
MIDWEST	133.2	143.3
SOUTHWEST	135.2	178.1
WESTERN	108.7	207.0

* DOUBLE LEVERAGE IS DEFINED AS EQUITY INVESTMENTS IN SUBSIDIARIES AS A PERCENT OF TOTAL SHAREHOLDERS' EQUITY.

SOURCE: LYONS, ZOMBACK & OSTROWSKI, INC., DEPOSITORY INSTITUTIONS PERFORMANCE DIRECTORY, BANK HOLDING COMPANIES, YEAREND 1985.

TABLE VI

EARNINGS DATA*
FDIC-INSURED COMMERCIAL BANKS, 1981-1986

	1986	1985	1984	1983	1982	1981
RETURN ON ASSETS	0.74%	0.87%	0.94%	1.02%	1.10%	1.18%
RETURN ON EQUITY	8.75%	10.19%	10.96%	11.96%	12.90%	13.65%

* INFORMATION OBTAINED FROM THE UNIFORM BANK PERFORMANCE REPORTING SYSTEM. RATIOS REPRESENT THE UNWEIGHTED AVERAGE OF THE RATIO VALUE OF EACH INSURED COMMERCIAL BANK.

TABLE VII

NUMBER OF FDIC FIELD EXAMINERS

YEAR	NUMBER
1986	1,726
1985	1,547
1984	1,389
1983	1,481
1982	1,551
1981	1,655
1980	1,698
1979	1,713
1978	1,760
1977	1,644
1976	1,556
1975	1,455
1974	1,381
1973	1,622
1972	1,603
1971	1,606
1970	1,581

The CHAIRMAN. Thank you, Mr. Seidman.
Governor Johnson.

STATEMENT OF MANUEL JOHNSON, VICE CHAIRMAN, FEDERAL RESERVE BOARD

Mr. JOHNSON. Thank you, Mr. Chairman. Like the others, I've prepared about a 10-minute summary statement to give, although I'm not sure it's been totally adjusted for a slow talking southern speaker, but I'll see if I can meet the time requirement.

First, in looking at the financial condition of the banking system, it is important to consider the environment within which banking organizations have been operating in recent years. Without question, the environment has been a difficult one, characterized by considerable financial stress and volatility. As a consequence, the industry as a whole has experienced rising levels of loan charge-offs and classified assets and, of course, the number of problem banks and failed banks has also increased significantly.

REASONS FOR PROBLEM BANKS AND FAILED BANKS

There are many explanations for this situation. One, undoubtedly, is the effect of the transition to a less inflationary environment on collateral values. Also, the transition from a period of low or negative real interest rate and expanding export markets to a period of high real interest rates and declining export revenues left many borrowers in less developed countries in weakened positions.

During this period, banking organizations also have been confronted with competitive challenges from thrifts, foreign banks, and even nondepository financial institutions. The direct issuance of securities has proven to be a less expensive and more efficient form of financing than bank loans for many of the banking industry's prime customers. And the deregulation of interest rates and the dismantling of geographic barriers have placed pressure on the margins of some institutions, although these developments should lead to a more sound and efficient banking system over time.

Yet, despite these economic dislocation problems and competitive challenges, most banking organizations remain fundamentally sound, and it is important not to lose sight of the elements of strength that underlie our banking system. To be sure, asset quality problems remain and segments of the industry have been weakened by troubled farm, energy, real estate, and foreign loans. On the other hand, many institutions continue to record favorable operating results, and the industry as a whole continues to build its capital strength.

Loan problems and loan losses have increased during the past few years, despite more than 4 full years of economic expansion, as the chairman has pointed out. The failure of asset quality to improve during the current economic expansion is due to special national and international economic conditions that have adversely affected particular borrowing sectors. The most obvious examples domestically are agriculture and energy.

Depressed conditions in these two sectors have created serious problems for banks in certain geographic areas, particularly in the

Farm Belt States of the Midwest and the energy-dependent States in the Southwest.

Nonetheless, there are some signs that conditions may be stabilizing. The price of oil has recovered somewhat from very low levels, and in some areas the decline in farm asset prices has leveled off. While adverse effects on banks that lend heavily to these sectors will continue, we have, I believe, begun to work through these problems, and absent any unanticipated shocks, the worst may be behind us in these sectors.

We need to maintain our vigilance, though, over these and other areas of the loan portfolio. In parts of our country that witnessed the energy boom and bust, problems have spilled over into the real estate industry. Thus, the banking industry remains exposed to conditions in the real estate market.

An important determinant of asset quality at the major money center banks and some regional institutions continues to be the debt problems of the less developed countries. The adjustment process that they have undergone has been painful and the difficulties facing these borrowers remain serious. Nonetheless, some progress has been made in dealing with this situation. Since 1982, the capital of the 50 largest U.S. banking organizations has roughly doubled and their exposure to the heavily indebted countries relative to their capital bases has declined sharply. In my view, the international debt problem has been managed to date through an extraordinary cooperative effort by borrowing countries, the international banking community, multilateral financial institutions, and creditor governments.

It is important to note, in particular, that events of recent days underscore the prudence and wisdom of efforts, over the last several years, to strengthen the capital bases of our larger institutions. The support of Congress is manifested in the International Lending Supervision Act of 1983, together with actions by both bankers and regulators in recent years, have resulted in significantly higher capital levels at most of our larger banking organizations. This should enable banks to withstand the pressures stemming from international lending difficulties.

In terms of banking profitability, the economic and structural difficulties just mentioned have inevitably placed downward pressure on the earnings and profitability of the banking industry.

The deterioration in asset quality that I have described has been the dominant factor underlying declining industry profitability. U.S. banks' loan loss expenses, measured as a percent of average assets, have tripled since 1981. Banks have also been affected by the loss of high quality borrowers to the capital markets. However, declining interest rates have allowed banks to offset a substantial portion of their credit losses with gains from the sale of investment securities. Moreover, some of the largest banking organizations have cushioned the impact of credit quality problems on profitability by achieving a robust growth in other noninterest income, reflecting their increased emphasis on fee-based services, such as investment banking, securities processing, and cash management.

It is important to realize that much of the U.S. banking industry remains profitable, and those banks that have avoided the most serious asset quality problems generally have fared quite well.

CAPITAL POSITIONS

In terms of bank capital, while trends in banking conditions over the last few years may give rise to some uneasiness, our Nation's banks, fortunately, have made considerable progress in raising capital. The larger banking institutions have made especially noteworthy improvement in their capital positions since the end of 1981. Of course, a complete assessment of capital adequacy must take account of both the quality of a banking organization's assets and the amount of any off-balance sheet exposure.

In an attempt to provide some insight into the effect of the growth of off-balance sheet items on capital trends, we have looked at a number of capital ratios adjusted for off-balance sheet risks. Based on our analysis, the capital ratios of the largest banking institutions appear to have improved over the last several years, even when off-balance sheet activity is taken into consideration.

Capital ratios are, of course, lower if adjustment is made for problem assets, as pointed out in the chart. Yet, even if capital is reduced by a percentage of classified loans, we find that there has been an improvement for medium size and large institutions over the 1982 interval.

As you may know, we have recently proposed, in conjunction with the other Federal banking agencies and the Bank of England, a risk-based capital framework. In addition to factoring off-balance sheet risks into our analysis, another important objective of this proposal is to recognize that certain liquid, low-risk assets require less capital backing than standard loans.

A major objective of the risk-based capital framework is to reduce the competitive inequities that can arise when supervisory authorities in countries around the world introduce different capital requirements. I cannot emphasize strongly enough our interest in the competitiveness of U.S. banks. Only a strong, competitive and profitable banking system can remain healthy in the long run and fulfill the strategic role banks play in our economic and financial system.

Now over the last several years, the Federal Reserve has addressed the trends and conditions I have just described with a number of important actions designed to strengthen our supervisory policies, practices, and procedures.

I have already noted the efforts the Federal Reserve, together with the other Federal banking agencies, has made over time to encourage banking organizations to strengthen their capital positions. In addition, within the last 2 years, we have intensified our review of dividend payments by banking organizations and, when appropriate, have encouraged them to conserve their capital by adopting more prudent dividend policy.

We have, as you may be aware, taken other prudential actions. Much time and effort has been devoted to heightening banking organizations' awareness of the potential risks associated with daylight overdrafts in large dollar payments systems and to giving bankers and examiners alike improved analytical and supervisory tools to monitor and control these risks. More recently, we have reiterated as clearly as possible our longstanding policy that bank

holding companies should serve as a source of financial and managerial strength to their subsidiary banks.

In addition, we have taken actions to improve our ability to monitor the emergence of supervisory problems in banking organizations. In 1986, we increased the frequency of examinations to provide for at least an annual examination of State member banks and most large bank holding companies and semiannual examinations or on-site reviews for very large institutions and problem companies. We also have revised our reporting requirements for bank holding companies to place greater emphasis on such indicators as the level of nonperforming loans and off-balance sheet activities.

Taken together, those actions have strengthened our ability to monitor risk-taking and improved our capacity to take enforcement actions.

Actions of the type I have just reviewed, of course, cannot deal with all of the problems facing our depository institutions. Thus, the Board continues to support legislation to recapitalize the FSLIC fund at an appropriate level and to provide Federal regulators with authority to arrange interstate acquisitions of failing and failed institutions.

As you are aware, the Board has recently approved the applications of certain bank holding companies to engage in underwriting commercial paper, 1–4 family mortgage-backed securities, and municipal revenue bonds. We have approved these applications subject to conditions to assure that the activity will be consistent with safe and sound banking practices and avoid conflicts of interest, concentration of resources, and other possible adverse effects.

We believe these activities should result in real benefits to banking organizations by promoting greater efficiencies, more competitive equity and more diversified sources of income. These will also, I believe, contribute to a stronger, more resilient banking system. In addition, a prudent expansion of bank holding company powers should provide significant benefits to customers in the form of greater convenience and competition and additional alternatives for obtaining important financial services. For this reason, we continue to urge Congress to recognize the competitive, technological, and international forces at work in banking and financial markets by providing a clear legislative framework for expanding the authority of bank holding companies to provide financial services consistent with the need to maintain a safe and sound banking system and safeguards against conflicts of interest and selfdealing.

Thank you, Mr. Chairman.

[The complete prepared statement of Manuel H. Johnson follows:]

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May 21, 1987

Statement by

Manuel H. Johnson

Vice Chairman

Board of Governors of the Federal Reserve System

before the

Committee on Banking, Housing, and Urban Affairs

United States Senate

May 21, 1987

I am pleased to meet with this Committee to present the views of the Board of Governors on the condition of the banking system and to address the general areas covered in your letter of invitation. The Federal Reserve staff has worked with the other depository institution regulatory agencies and members of your staff to provide financial information and data on the condition of U.S. banking organizations. It is not my intent here to review all of these data in detail; rather, I intend to discuss our views on broad developments and conditions in the banking system and what supervisory steps we have taken to address these conditions.

In looking at the financial condition of the banking system, it is important to consider the environment within which banking organizations have been operating in recent years. Without question, the environment has been a difficult one -- characterized by considerable financial stress and volatility. As a consequence, many institutions, many segments of the industry, and, indeed, the industry as a whole have experienced rising levels of loan charge-offs and classified assets and, of course, the number of problem banks and failed banks has also increased significantly.

These problems are rooted in several causes. One, undoubtedly, is the transition to a less inflationary environment. As you know, inflation rates have drifted from double-digit levels in the late 1970s and early 1980s to low single-digit levels in each of the last several years. Unfortunately, inflationary expectations supported many farm, energy, and real estate loans that, in hindsight, we now know were not viable. This situation was aggravated by steep back-to-back recessions in the early 1980s that left a legacy of troubled loans, even as the economy began to recover in late 1982. A second type of economic transition--from a weak dollar to a strong dollar--struck hard at another large segment of the banking industry's customer base: manufacturers of internationally traded goods. Finally, the transition from a period of low or negative real interest rates and expanding export markets to a period of high real interest rates and declining export revenues, coupled with other factors, left many borrowers in less developed countries in weakened positions.

During this period, banks also have been confronted with competitive challenges from several directions. Thrifts, foreign banks, and even nondepository financial institutions have emerged as formidable competitors in many areas. The direct issuance of securities has proven to be a less expensive and more efficient form of financing than bank loans for many of the banking industry's prime customers. And, the deregulation of interest rates and the dismantling of geographic barriers have placed pressure on the margins of some institutions, although

these developments should lead to a more sound and efficient banking system over time.

All of this was compounded by the inclination on the part of some depository institution managers to assume excessive risks with federally-insured deposits in the hope that the expected high rewards would accrue to investors. By far the majority of banking organizations are well-managed; however, mismanagement, improper lending practices, and other forms of excessive risk-taking have contributed to financial problems and the failure of a number of institutions.

Yet, despite these economic dislocations, problems and competitive challenges, most banking organizations remain fundamentally sound, and it is important not to lose sight of the important elements of strength that underlie our banking system. To be sure, asset quality problems remain and segments of the industry have been weakened by troubled farm, energy, real estate and foreign loans. On the other hand, many institutions continue to record favorable operating results, and the industry as a whole (and particularly the group of larger institutions) continues to build its capital strength. Indeed, I suspect that many institutions that have withstood the recent pressures on the industry may emerge in a much stronger competitive position.

Asset Quality

Asset quality difficulties have contributed to the prevailing unease about the health of the banking system. Loan problems and loan losses have increased during the past few

years, despite more than four full years of economic expansion. This experience is especially troublesome and contrary to that of recent decades. In past periods of recession and recovery, a consistent pattern was observed: loan losses increased during the recession and immediately afterwards, but then improved as economic growth resumed. The relatively high level of troubled assets at some banks at this point in the recovery suggests that any major unforeseen economic or financial shocks could test the resiliency and solvency of the most vulnerable institutions.

The failure of asset quality to improve during the current economic expansion is due to special national and international economic conditions that have adversely affected particular borrowing sectors. The most obvious examples domestically are the agricultural and energy sectors. In the late 1970s and early 1980s, borrowers in these sectors took on large amounts of debt that could not be serviced when conditions subsequently deteriorated. While the wringing out of inflation had an important positive impact on the economy as a whole, the declines in the value of farm property and the price of oil led to an increase in the level of delinquencies and defaults on bank loans.

Depressed conditions in these two sectors have created serious problems in certain geographic areas. Particularly hard hit have been banks in the farmbelt states of the midwest and the energy-dependent states in the southwest. Asset quality measures of banks in these areas are generally lower than those of banks in other parts of the country.

Nonetheless, there are some signs that conditions may be stabilizing. The price of oil has recovered somewhat from very low levels, and in some areas the decline in farm asset prices has leveled off. While adverse effects on banks that lend heavily to these sectors will continue, we have, I believe, begun to work through these problems, and absent any unanticipated shocks, the worst may be behind us in these sectors.

We need to maintain our vigilance, though, over these and other areas of the loan portfolio. In parts of our country that witnessed the energy boom and bust, problems have spilled over into the real estate industry. New construction, especially for downtown office buildings, has finally slowed and even come to a virtual stop in some energy-area markets, such as Houston. Nonetheless, these markets remain depressed, with a large relative supply of available office space. Moreover, while construction has slowed in these markets, it has not done so in the aggregate. In 1986, real estate construction loans held by banks grew by nearly 20 percent, while total loans grew by less than 8 percent. Over the last three years, construction loan growth averaged 21 percent, compared with a total loan growth average of 10 percent. Thus, the banking industry remains highly exposed to conditions in the real estate market. Although 1986 witnessed some improvement in real estate vacancy rates, they remain relatively high by historical standards.

One additional area of the domestic loan portfolio that bears continued attention in the future is that of credit card loans. In recent years, many banks have solicited new

accounts in a very aggressive fashion and have purchased existing accounts. These methods of securing new accounts have resulted in historically high charge-off rates. Although there is evidence that such rates may be peaking, losses are expected to remain high and many credit card portfolios remain vulnerable to narrowing margins and possible increased delinquencies.

An important determinant of asset quality at the major money center banks and some regional institutions continues to be the debt problems of the less developed countries. The adjustment process they have undergone has been painful and the difficulties facing these borrowers remain serious; nonetheless, some progress has been made in dealing with this situation. Despite some significant exceptions, most countries have been able to service their indebtedness over the last four and a half years. During this period, banks have been able to significantly improve their ability to absorb any losses from their loans to countries with debt problems. Since 1982, the capital of the 50 largest U.S. banking organizations has roughly doubled while exposure to troubled LDC borrowers has actually declined slightly. Thus, their exposure to the heavily indebted countries relative to their capital bases has declined sharply.

At the same time, many borrowing countries have made progress in strengthening their economies and their ability to service their external obligations. Most of these economies now are experiencing real growth, reducing their combined current account deficits considerably, and instituting many needed economic reforms. In the case of some countries, this has been

achieved despite a significant decline in commodity prices and export revenues. In my view, the international debt problem has been managed through an extraordinary cooperative effort by borrowing countries, the international banking community, multilateral financial institutions and creditor governments. Moreover, while banks have shown a willingness to work with countries that undertake appropriate adjustment policies, this has been done without an excessive build-up of additional debt. The external debts of heavily indebted developing countries have increased at only a 3-1/2 percent annual rate over the past four years which, under normal circumstances, would imply declining debt burdens.

While I believe we are on a track that offers a reasonable prospect of long-run success, this is not to say, of course, that individual countries will not experience renewed problems from time to time. For example, Brazil is now facing a resumption of serious inflationary pressures which, with other factors, has led to a curtailment of debt service. It will take, no doubt, the concerted effort of Brazil and all of its creditors to manage this situation. Nonetheless, despite the impact that the international debt situation has had on bank earnings and asset quality, U.S. banks to date have proved able to cope with the effects of foreign debt problems and, in particular, with Brazil's moratorium on interest rate payments.

It is important to note that events of recent days underscore the prudence and wisdom of efforts, over the last several years, to strengthen the capital bases of our larger

institutions. The support of Congress, as manifested in the International Lending Supervision Act of 1983, together with actions by both bankers and regulators in recent years, have resulted in significantly higher capital levels at most of our larger banking organizations. This should enable banks to withstand the pressures stemming from international lending difficulties of the type being experienced by Brazil. Indeed, it is a fundamental function of capital to absorb losses stemming from unanticipated shocks while maintaining confidence in the banking system. Although the difficulties facing many foreign borrowers are significant, the problems in Brazil should not obscure the progress made with other debtors. During 1987, new lending agreements have been signed or tentatively agreed to with Mexico, Chile, Venezuela, Argentina and the Philippines.

Having generally reviewed those segments of the loan portfolio that have been cause for concern in recent years, I would now like to address briefly recent trends in certain broad indicators of loan quality.

Overall, loan losses trended upward for most of this decade. For all insured commercial banks, the ratio of net charge-offs to average total loans has increased steadily since 1981; by year-end 1986, it had reached nearly one percent, an unusually high level for the industry as a whole.

Looking at specific size classes of banks, we find that the overall trend describes accurately each size group. No size class has fully escaped the general deterioration in asset quality, although some have done better than others.

In general, banks with assets of less than $100 million have the highest relative level of loan losses. The problems experienced by smaller banks largely reflects the relatively high concentration of agricultural credits in many of these institutions. The smaller regional banks, those with assets of between $1 billion and $5 billion dollars, have had the best performance, relatively speaking.

Nonperforming assets give some general idea of the level of problems in the loan portfolio. Nonperforming assets have increased or remained at relatively high levels in the last several years despite the extraordinarily high level of loan charge-offs over this same period. Among the various size groups of banks, nonperforming asset ratios are generally highest at the largest and the smallest banks. At year end 1986, for example, nonperforming assets averaged 2.34 percent of total assets for the 25 largest banks, up from 2.25 percent a year earlier.[1] For the smaller banks, those with assets of less than $300 million, the nonperforming ratio stood at 2.09 percent, unchanged from the prior year-end level. As I have already suggested, nonperforming assets are higher than we would like at this point in the economic cycle.

In general, the difficult period of asset quality problems through which we are passing firmly underscores, for

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[1]The figures for year-end 1986 do not include the effects of placing Brazilian debt in nonperforming status, which occurred in the first quarter of 1987.

both bankers and supervisors alike, the need for renewed attention to sound and prudent lending standards and practices, as well as the need for continued efforts to strengthen capital adequacy.

You have asked that we address the effect of "securization" on asset quality. Simply stated, a securitized loan is one in which the originator is not the ultimate investor. In a typical loan securitization, the originator sells a bundle of loans, rather than individual loans, and the loans are converted to securities backed by the loans. Of course, depository institutions can act as both buyers and sellers of securitized loans. Until now, loan securitization has occurred mainly in the residential mortgage market, where over half of all loans that are originated are subsequently securitized. Other assets that have been securitized on a much smaller scale include automobile loans, credit card receivables, lease receivables, and commercial real estate.

Securitization offers the potential benefits of diversification of credit risk, improved control over interest rate exposure, enhanced liquidity, and increased efficiency. The question of how securitization will affect asset quality, however, is difficult to answer with precision. The answer will no doubt lie ultimately in the quality of underwriting performed by those originating the loans to be securitized. The quality of lending could improve if securitization results in greater specialization and standardization in lending and if it is performed by the industry's most capable lenders. On the other

hand, there is always the danger that too many institutions will attempt to participate in the securitization process and that credit underwriting standards will be compromised in the battle for market share. From a supervisory standpoint, we expect banking organizations that purchase securitized assets to conduct proper credit analyses and to assure themselves of the quality of the assets they are taking into their portfolios.

We sometimes hear that if banks securitize and sell their highest quality assets, the overall quality of bank assets will decline as relatively weaker assets that cannot be sold are retained on the balance sheet. While I see no necessary reason that banks that engage in this activity should relax their credit standards in general, examiners will, of course, continue to evaluate the condition of assets retained in selling bank portfolios, and supervisors have the latitude to require additional capital if an institution's credit profile changes as a result of such transactions.

One supervisory concern regarding securitization relates to whether the selling institution achieves a complete transfer of risk to the buyer before removing the "sold" assets from its books. Obviously, if the seller retains an explicit or implicit obligation to repurchase the securities with the aim of providing a credit guarantee or liquidity support, then the transaction has not reduced the risk to the selling institution. Moreover, if such obligations were, in fact, retained in connection with a large number of such "sales," risk could be significantly increased. To deal with this concern, we have

generally recognized transactions as true sales only if the seller retains no risk of loss to its capital base. In general, if the holder of the securities has recourse to the bank, that is, if the bank is at risk, the transaction must be kept on the bank's balance sheet and the risk of loss must be backed by capital.

Earnings and Profitability

The economic difficulties and imbalances that have marked the 1980s inevitably have placed downward pressure on the earnings and profitability of the banking industry. Aggregate after tax earnings growth slowed from about an 11 percent annual rate in the 1970s to about a five percent annual rate in the first half of the 1980s, and earnings actually declined about one percent last year. Over this same period, asset and equity growth also have slowed, but more moderately. Consequently, key measures of aggregate industry profitability--return on assets and return on equity--last year fell to the lowest levels since at least 1970.

The deterioration in asset quality that I have described has been the dominant factor underlying declining industry profitability. U.S. banks' loan loss expenses, measured as a percent of average assets, have tripled since 1981. Indeed, this development accounts for much of the decline in profitability during this period. Declining interest rates have allowed banks to offset a substantial portion of their credit losses with gains from the sale of investment securities.

Profits from the sale of investment securities accounted for about one-sixth of total pre-tax income for the banking industry last year. Some of the very largest banking organizations have cushioned the impact of credit quality problems on profitability by achieving a very robust growth in other noninterest income, reflecting their increased emphasis on fee-based services, such as investment banking, securities processing, and cash management. It is not clear, however, how much these activities have contributed to the net income of these banks since data necessary to allocate certain expenses is not available. It is known that expansion of fee-based services has required substantial noninterest expenses in the form of investments in technology and the hiring of highly-paid staff. Indeed, at some of the largest banks, the growth of noninterest expense has outstripped that of noninterest income.

It is extremely important to realize, however, that much of the U.S. banking industry remains profitable. Earnings difficulties have been concentrated in the western half of the country, where the problems in the energy and agricultural sectors have loomed large and at the major multinational banks, which have been hurt by foreign loans and, in some cases, by concentrations of energy, real estate, and shipping loans. The largest banks also have been adversely affected by the loss of many of their most creditworthy customers to the securities markets and to foreign banks.

Those banks that have avoided the most serious asset quality problems generally have fared quite well. Indeed, the return on assets

was at or near peak levels last year for many regional banks located in Federal Reserve Districts in the eastern half of the country. The resiliency of the banking industry is evident in data on net interest margins, that is, net interest income as a percentage of assets. Although the margins dipped somewhat last year, they remained well above the average for the 1970s. The deregulation of deposit interest rates does appear to have contributed to a narrowing of margins at smaller banks from the very high levels recorded early in this decade, but even at these banks margins generally compare favorably with historical levels. What is not clear, however, is the extent to which the attempt to earn high margins has induced banks to hold riskier loan portfolios.

Capital

While trends in banking conditions over the last few years may give rise to some uneasiness, our nation's banks, fortunately, have made considerable progress in strengthening their capital positions. This development is particularly noteworthy because capital plays a central role in fortifying the banking system. It acts as the buffer that provides protection to depositors, other creditors, and the deposit insurance fund when an institution reports negative earnings. The protection capital offers also serves to maintain confidence in the banking system as a whole.

It was only a few years ago that capital levels in the banking industry caused considerable apprehension about the

ability of some banks to weather a difficult economic and financial environment. This apprehension was accentuated by the buildup in problem loans and off-balance sheet exposures that in many instances accompanied the thinning of capital cushions. Against this background, in December, 1981, the three federal bank regulatory agencies adopted formal minimum capital standards for banks and bank holding companies in order to halt the secular decline in capital ratios that had occurred and to counterbalance the increase in risk-taking that became evident during the 1970s. It is therefore comforting to note that since the adoption of the guidelines, the industry's capital base has been bolstered steadily by the issuance of common and preferred stock and long-term debt, and by the buildup of loan loss reserves.

Currently, all banks and bank holding companies must meet a minimum primary capital requirement of 5.5 percent and a minimum total capital requirement of 6.0 percent.[2] As these levels are minimums, banks normally are expected to, and in fact do, operate above them.

From our perspective, the capital guidelines have worked reasonably well. The long secular decline in bank capital ratios has been reversed. The larger banking institutions have

[2]The principal components of primary capital are common stockholders' equity, perpetual preferred stock, loan loss reserves and certain debt instruments that must convert to stock. Total capital consists of primary capital plus secondary capital instruments--such as limited-life preferred stock and certain qualifying long-term debt securities.

made especially noteworthy improvement in their capital positions since the end of 1981. Over this period, the average primary capital ratio of the nation's 50 largest bank holding companies jumped from 4.7 percent to 7.1 percent -- which is well above the minimum guideline level of 5.5 percent. Of course, a complete assessment of capital adequacy must take account of both the quality of a banking organization's assets and the amount of any off-balance sheet exposure.

With regard to the latter, financial innovation has given birth to a wide variety of financing instruments which carry varying degrees of risk and serve different purposes but which do not find their way onto banks' balance sheets. Interest rate swaps, financial futures and options, forward rate agreements, and foreign exchange contracts are among the off balance sheet instruments banks use either to capitalize on or to hedge against interest rate and foreign exchange risks. Another group of off balance sheet items, often referred to as "direct credit substitutes," includes financial guarantees and standby letters of credit that back financial claims of third parties. A bank issuing such instruments bears essentially the same credit risk that it would have if it made a direct extension of credit to the customer. Commitments form yet another broad group of off balance sheet exposures.

The total volume of the industry's off balance sheet business is considerable. At year-end 1986, standby letters of credit issued by insured commercial banks amounted to $170 billion, foreign exchange commitments came to $893 billion, loan

commitments were $571 billion, and interest rate and cross currency swaps totaled $376 billion. The numbers appear staggering, as indeed they are. However, it clearly would be inappropriate and misleading to relate the total volume of off-balance sheet exposures to the capital requirements of the banking industry. This is because in many cases the principal or face value of the instruments is not an indicator of the amount that is at risk, and because many of the assorted off balance sheet activities are used by banking institutions to reduce their exposure to risk. Therefore, it is important to look at these activities on a risk-adjusted basis.

In an attempt to provide some insight into the effect of the growth of off balance sheet items on capital trends, we have looked at a number of capital ratios adjusted for off-balance sheet risks. Based on our analysis, the capital ratios of the largest banking institutions appear to have improved over the last several years--even when off balance sheet activity is taken into consideration. For example, the ratio of primary capital to total assets including adjustments for off-balance sheet items for the 10 largest bank holding companies has climbed from 4.0 percent in December 1981 to 6.2 percent by year-end 1986. These results are not surprising given the huge amounts of new capital banks have raised over the last several years. These trends clearly demonstrate why capital, which long has been a sore point for the banking industry is becoming an important selling point for major U.S. banking institutions, which now are among the most strongly capitalized in the world.

As you may know, we have recently proposed, in conjunction with the other federal banking agencies and the Bank of England, a risk-based capital framework. In addition to factoring off-balance sheet risks into our analysis, other important objectives of this proposal are to recognize that certain liquid, low-risk assets require less capital backing than standard loans and to achieve greater convergence in the assessment of capital adequacy among countries with major financial centers. We currently do not collect all of the data necessary to calculate precisely the ratio as proposed. However, estimates for the 10 largest banking holding companies averaged approximately 6.3 percent as of June 30, 1986; by year end this figure had increased to 6.6 percent.

Capital ratios are, of course, lower if adjustment is made for problem assets. This is not surprising since one of the major functions of capital is to absorb losses resulting from problem loans. Yet, even if capital is reduced by a percentage of classified loans, we find that there has been an improvement over the 1982-1986 interval. For the 25 largest banks, for example, the average ratio of primary capital, adjusted for problem assets, to total assets increased from 4.0 percent at year-end 1982 and to 5.6 percent by year-end 1986. Some improvement in this ratio, albeit on a more modest scale, was also reported for other banks with assets of $1 billion or more. On the other hand, we noted some deterioration in this ratio for banks in the less than $300 million size category. The average for this group declined from 8.0 percent in 1982 to 7.7

percent by the end of 1986. This decline was in large part due to the disproportionate share of problem farm loans held by small banks.

An important goal of the recent joint proposal of the U.S. federal banking agencies and the Bank of England for the establishment of a risk-based capital framework was to reduce the competitive inequities that can arise when supervisory authorities in countries around the world introduce different capital requirements. I cannot emphasize strongly enough our interest in the competitiveness of U.S. banks. Only a strong, competitive and profitable banking system can remain healthy in the long run and fulfill the strategic role banks play in our economic and financial system. Thus, the Federal Reserve is committed to working with supervisors from other countries to encourage the development and adoption of more consistent and broadly accepted international capital standards of the type set forth in the U.S./U.K. proposal.

Another dimension of the issue is the competition from nonbank financial institutions, including thrifts institutions. Again, as a matter of both competitive equity and prudential concerns, it would seem desirable to bring the capital requirements of competing institutions into closer alignment. For this reason, we strongly support the efforts of the Federal Home Loan Bank Board to encourage thrift institutions to strengthen their capital positions.

You specifically asked that we address the issue of "double leveraging". Double leveraging refers to the practice of

a parent company transforming debt it issues into equity at the subsidiary level. A bank holding company can leverage itself by issuing long-term debt and can then channel, or "downstream", the proceeds of the offering to its bank or nonbank subsidiaries by purchasing their equity securities. Double leveraging is often used to increase the capital of a subsidiary bank in order to satisfy regulatory capital requirements. By using the parent as a centralized conduit for the capital financing of subsidiaries, an organization can reduce its cost of raising funds.

An organization using double leveraging runs the risk that its subsidiaries will not be able to "upstream" the cash flow needed to service the parent's debt. A bank subsidiary, for example, may fail to earn sufficient income to pay dividends, the principal source of funds parent companies use to service their debt. The risks of double leveraging are borne by a parent organization's shareholders and uninsured creditors.

A commonly used measure of double leverage is the ratio of the parent company's equity investments in its subsidiaries to total parent company equity. Last year there was a significant decline in levels of double leveraging in the banking industry. The decline was particularly pronounced among the largest holding companies, where as a group, the ratio for the 25 largest dropped from 158 percent at year-end 1985 to 125 percent by year-end 1986. The decline in double leveraging can be attributed, in part, to a heightened awareness on the part of holding company creditors that the flow of funds from bank subsidiaries to the parent company cannot be assured, and in

part, to increased supervisory scrutiny of parent company cash flow and its potential impact on the capital of subsidiary banks. In addition, since we apply our capital standards to consolidated holding companies as well as their subsidiary banks, there is a limit on the potential incentive for excessive double leveraging.

Liquidity

Liquidity is a difficult concept to define with precision and judgments on liquidity require consideration of a number of factors pertaining to both the asset and liability side of the balance sheet, as well as to off-balance sheet commitments. However, one helpful measure of liquidity is the degree of reliance on volatile, purchased liabilities to fund assets. Reliance on such liabilities has decreased in recent years, primarily because of the deregulation of interest rates which has enabled banks to compete more effectively for retail accounts. This trend has been offset to some degree by a decline in the holding of certain liquid assets by banking institutions; nonetheless, on net, liquidity appears generally to have improved over the last several years. Although dependence on managed liabilities has changed little in recent years at smaller banks, deregulation has removed the threat of deposit disintermediation, which was perhaps the most serious threat to their liquidity.

Brokered deposits generally have remained a very small share of total deposits of banks, and thus, for the most part,

have not had a significant impact on liquidity. Although brokered funds have been abused in some specific cases, supervisors monitor the use of such funds closely, particularly in connection with our review of the overall use of purchased liabilities.

Problem and Failed Institutions

It is a widely known fact that the number of problem and failed banking organizations has risen at an uncomfortably rapid pace over the last several years. It is our expectation that, absent unforeseen adverse economic or financial developments, these numbers many begin to level off. However, we do not expect these numbers to decline in a significant way in the near term.

In data submitted to the Committee staff, the banking agencies have provided information on the total number of problem and failed commercial banks, and their aggregate deposits, in some detail. Therefore, I will touch briefly on the situation with respect to institutions under the jurisdiction of the Federal Reserve System.

At the end of March, 1987, there were 85 problem state member banks and 510 problem bank holding companies. These 85 state member banks represented 7.7 percent of all state member banks, while the 510 bank holding companies represented 7.9 percent of all bank holding companies and controlled approximately 8.5 percent of total banking assets.

As of May 8, 1987, 74 commercial banks had failed, compared with 41 over the same period in 1986. Of the 74 banks that failed, 5 were state member banks with total assets of $243 million; in all of 1986, 11 state member banks with total assets of $147 million failed. Over the five-year period of 1982 through 1986, the assets of failed state member banks represented 5 percent of total failed bank assets. To put this figure into perspective, state member banks comprised 18 percent of total bank assets at year end 1986.

Supervisory Actions

Over the last several years, the Federal Reserve has addressed the trends and conditions I have just described with a number of important actions designed to strengthen our supervisory policies, practices and procedures. Our objectives have been threefold: first, to implement supervisory policies that would improve the ability of banking organizations to withstand financial stress and adversity; second, to enhance our ability to identify in a timely manner financial and operating deficiencies that could weaken an organization's financial condition; and third, to strengthen our follow-up procedures, particularly by improving our techniques for communicating with boards of directors and, where appropriate, broadening our use of formal enforcement actions.

In carrying out our supervisory responsibilities, we attempt to balance the need to maintain a fully adequate supervisory framework with our desire to avoid impinging on the

legitimate prerogatives of management or undercutting the benefits from greater competition in our banking and financial markets. While views may differ on the best way to strike this balance, the crucial public interest in the maintenance of a sound and stable banking system, and the existence of the federal "safety-net," underscore the critical importance of a strong and effective supervisory and regulatory framework.

I have already noted the efforts the Federal Reserve, together with the other federal banking agencies, has made over time to encourage banking organizations to strengthen their capital positions. The imposition of minimum capital standards in 1981, and the strengthening of these standards in 1983 and 1985, have played an important role in helping banking institutions to withstand the strains of the last several years.

In carrying out its day-to-day supervisory activities, the Federal Reserve has encouraged banks to operate above the minimum capital ratios established by regulatory rules. Banking organizations undertaking significant expansion are expected to maintain particularly strong capital positions that are well above minimum supervisory standards. In addition, within the last two years, we have reiterated and strengthened our policy on the payment of cash dividends to shareholders when a banking organization is experiencing financial problems. Accordingly, we have intensified our review of dividend payments by banking organizations and, when appropriate, have encouraged them to conserve their capital by adopting more prudent dividend levels.

As I have stated, we are in the process of further improving our capital adequacy policies through adoption of risk-based capital standards. A major objective of our risk-based capital proposal, as I have indicated, is to ensure that capital is adequate to support off-balance sheet exposures. In addition, our adoption of a risk-based capital framework will help to more accurately match an organization's capital requirements with its level of risk-taking and will contribute to broader international efforts to enhance capital standards for large multinational banking institutions. Such efforts are aimed at achieving stronger, more stable international banking institutions and markets, and at reducing the competitive inequities and distortions that can result from vastly different prudential rules among countries with important financial centers.

We have, as you may be aware, taken other prudential actions. Over the last several years, much time and effort has been devoted to heightening banking organizations' awareness of the potential risks associated with daylight overdrafts in large dollar payments systems and to giving bankers and examiners alike improved analytical and supervisory tools to monitor and control these risks. More recently, we have reiterated as clearly as possible our longstanding policy that bank holding companies should serve as a source of financial and managerial strength to their subsidiary banks. This is particularly important since banks benefit from the ability to issue federally-insured deposits and borrow from the Federal Reserve discount window. In

light of subsidiary bank access to these "safety-net" protections, we expect their holding companies to stand ready to use available resources to support their banks during periods of financial stress or adversity, and we have underscored our policy to use our enforcement authority, when warranted and appropriate, to see that this is done.

In addition, we have taken actions to improve our ability to monitor the emergence of supervisory problems in banking organizations. In 1986, we increased the frequency of examinations to provide for at least an annual examination of state member banks and most large bank holding companies and semiannual examinations or on-site reviews for very large institutions and problem companies. This program has been supported by a significant boost in budgetary resources devoted to supervision and regulation and by an increase in the number of examiners from 835 in 1985 to 914 at the end of 1986. This more frequent on-site examination program has also has been made possible, in part, through increased cooperation with state banking departments in the form of greater reliance on state examinations of certain institutions, and through increased operating efficiencies. We also have revised our reporting requirements for bank holding companies to place greater emphasis on such indicators as the level of non-performing loans and off-balance sheet activities.

Taken together, those actions have strengthened our ability to monitor risk-taking and improved our capacity to take enforcement actions. Indeed, since 1982, we have greatly

increased the number of enforcement actions such as cease and desist orders, written agreements and removal actions aimed at officers and directors. In the period 1980-82, the Federal Reserve System averaged 42 enforcement actions per year; from 1984-86, the average number of enforcement actions had increased to 177. Such actions are employed to require banks to improve their lending policies and procedures, strengthen management, terminate unsafe and unsound practices, and adopt more prudent funding, dividend and capital strategies.

Enforcement actions are but one form of supervision. Equally, or perhaps more, important are preventative actions such as our efforts to improve communications with directors who, of course, have primary responsibility to see that their institutions are operated safely and in compliance with banking laws and regulations. Toward this end, we have implemented a directors' summary report to spell out more clearly and effectively our supervisory assessment of an organization's problems and have broadened the involvement of senior Reserve Bank officials in meetings with directors of large institutions and those with significant problems.

Actions of the type I have just reviewed, of course, cannot deal with all of the problems facing our depository institutions. Thus, the Board continues to support legislation to recapitalize the FSLIC fund at an appropriate level. Moreover, while we are gratified by the actions taken by some state legislatures to permit out-of-state acquisitions of failed or failing banks, we do not believe these have alleviated the

problem of finding buyers for troubled institutions in certain states. Thus, the Board continues to urge Congress to provide federal regulators with authority to arrange interstate acquisitions of failing and failed institutions.

As you are aware, the Board has recently approved the applications of certain bank holding companies to engage in underwriting commercial paper, 1-4 family mortgage-backed securities and municipal revenue bonds. We have approved these applications subject to conditions to assure that the activity will be consistent with safe and sound banking practices and avoid conflicts of interest, concentration of resources, and other possible adverse effects. It is our hope that this action will provide banking organizations with additional sources of income and enhance in a meaningful way their ability to compete effectively with other nonbank financial institutions.

In the long run, of course, these activities should result in real benefits to banking organizations by promoting greater efficiencies, more competitive equity and more diversified sources of income. These will also, I believe, contribute to a stronger and more resilient banking system. In addition, a prudent expansion of bank holding company powers should provide significant benefits to customers in the form of greater convenience and competition and additional alternatives for obtaining important financial services.

In approving these applications, the Board acted under existing authority, applying a statute adopted over 50 years ago in very different circumstances, to a financial market place that

technology and competitive forces have altered in ways that the enacting Congress could not have envisioned. Thus, we continue to urge Congress to recognize the competitive, technological, and international forces at work in banking and financial markets by providing a clear legislative framework for expanding the authority of bank holding companies to provide financial services, consistent with the need to maintain a safe and sound banking system and safeguards against conflicts of interest and self-dealing. We also believe Congress should address the need for change in the current prohibitions on corporate underwriting, recognizing that bank holding companies conduct such activities abroad in substantial volume. As part of more comprehensive legislation in the future, we feel that it would also be desirable to consider ways of encouraging more consistency in accounting, supervisory, and capital standards among various types of depository institutions.

Conclusion

The recent trends in the performance and condition of our nation's banks, notably, the deterioration in asset quality, the slide in earnings and profitability, and the growth in off balance sheet exposures, explain much of the current unease about banking. But the industry has been working to reverse these trends and much progress is evident. Many banks have put in place cost cutting programs, strengthened their capital positions, adopted more conservative lending practices, and generated new sources of income. The supervisory agencies, for

their part, have implemented programs to help ensure that the banking system remains on a sound footing and that adequate safeguards are in place. All of these efforts should have the effect of putting banking organizations in a better position to withstand any additional unanticipated pressures and strains within our economy or financial markets.

While there is some justification for the prevailing sense of unease over banking, I believe that, on balance, much more is right in banking today than is wrong. The problems, while significant, are manageable, and I can assure this Committee that the Board will do its utmost to see that supervisory efforts will continue to be directed toward maintaining the soundness of the banking system.

The CHAIRMAN. Thank you, Governor Johnson.

The questioning will be 5 minutes and then we can have other rounds if the members would want that.

Mr. Johnson, Citicorp officials said yesterday that their $3 billion in new reserves amount to about 25 percent of the loans to what they call refinancing countries. That's a new term for me. Would the loans to these countries all fall into the OTRP or substandard or value impaired categories?

Mr. JOHNSON. I don't think that's the case. I've got our head supervisor here that might be able to clarify that point. I think that's right. He says pretty much, so I think that is right.

The CHAIRMAN. Now I ask this question with the understanding that you may or may not wish to give us a direct response. Perhaps you can't. Perhaps it's best not to. But I think the question ought to be asked.

Who are these refinancing countries?

Mr. JOHNSON. Well, I think that we could list all of those off, but I think that first I would have to say that I don't think it's clear from the Citicorp announcement that the provisions that they have made have been specifically against LDC debtor nations. I think that they made a contribution to the general reserve and, of course, because of that, I think that their provisions were associated with not just LDC countries.

The CHAIRMAN. So they didn't identify these as specific countries but simply took their LDC reserve and hit it with a 25-percent setaside for the increase in their reserves for those countries?

Mr. JOHNSON. Yes.

The CHAIRMAN. Now are these primarily Latin American countries?

Mr. JOHNSON. Well, I think the most obvious debtor countries are Latin American countries, but there are many others besides just Latin American debtor nations. But I want to continue to emphasize, I don't think that their contribution to their reserves was specifically geared toward just debtor nations.

The CHAIRMAN. Could you or would you consider providing us with a list of the refinancing countries and the current and yearend exposure in each of the 10 largest U.S. banking organizations to each of these countries?

Mr. JOHNSON. Yes, we would consider that, Mr. Chairman.

The CHAIRMAN. I hope you consider it favorably.

[The information referred to follows:]

CROSS-BORDER AND FOREIGN CURRENCY
OUTSTANDINGS OF TEN LARGEST U.S.BANKS TO
COUNTRIES EXPERIENCING LIQUIDITY PROBLEMS
(in billions)
as of
DECEMBER 31, 1986

	Argentina	Brazil	Mexico	Philippines	Venezuela	Chile
Citicorp	1.4	4.6	2.8	1.8	1.0	NA
Morgan Guaranty	.9	1.9	1.3	NA	NA	NA
Bankers Trust	NA	.8	1.3	NA	NA	NA
Chemical	.4	1.4	1.4	NA	.7	.5
Manufacturers Hanover	1.5	2.3	1.9	NA	1.0	.8
Security Pacific 1/	NA	.6	.6	NA	NA	NA
First Interstate 1/	NA	.5	.7	NA	NA	NA
Wells Fargo 1/	NA	.6	.6	NA	.2	NA
Bank of America	NA	2.7	2.5	NA	1.3	NA
Chase Manhattan	1.0	2.7	1.6	NA	1.1	NA

Banks are required by the SEC to report exposures to countries that exceed 1% of total assets.

1/ Disclosed exposures that represent .75% or greater of total assets.

NA - Exposures did not exceed the 1% of total assets disclosure limit.

The CHAIRMAN. Mr. Seidman, from the information Citicorp provided about its reserving decision—you or Mr. Johnson or Mr. Clarke can answer this—it appears that Citicorp's exposure to refinancing countries amounts to about $12 billion. The $3 billion in new reserves is said to be about 25 percent of its exposure to these countries.

If this is the case, Citicorp's $12.2 billion to Latin America and the Philippines alone account for all the exposure being reserved against.

Would I be incorrect to think that the new reserves consist of a 25-percent portion of Citicorp's exposure to Mexico, Brazil, Argentina, Chile, Venezuela, and the Philippines?

Mr. SEIDMAN. I think that would be a reasonable interpretation of what they said, that it's a general reserve across the board against all of these risks.

The CHAIRMAN. Mr. Clarke, prior to Citicorp's establishment of a $3 billion reserve against its troubled international loans, the GAO testified here in favor of congressional action to have our banks build such reserves. In that testimony, GAO said—and I quote the GAO report:

> Regulators in other countries have focused primarily on requiring large loan loss reserves. Canadian banks, for example, have been required to set aside loan loss reserves of 20 percent of their exposure to a basket of 32 LDC's.

Why is the Treasury Department and your office been so resistant to congressional initiatives to require banks to build bigger reserves against these troubled international loans? Do you really believe these loans are worth their book value?

RESISTANCE TO BUILDING RESERVES

Mr. CLARKE. Senator, you're really asking two questions. One is whether these loans are worth their book value. That's a subject, of course, of considerable debate. I think there is some argument at least with respect to some of the country debt that there will ultimately be no principal loss on those loans if everyone will help the countries work their way through to an ultimate solution.

The CHAIRMAN. That would be a very, very, very unlikely situation, wouldn't it? The biggest bank taking a $3 billion hit in one quarter with the understanding, well, possibly it will all be good.

Mr. CLARKE. If you look in detail at what the bank said when they made their announcement, they said that they had a particular strategy they intended to pursue, not that they thought those loans were just going to go bad. They said they had a particular game plan in mind.

The CHAIRMAN. Well, the question is not whether they will all go bad. Of course, they won't all go bad. But it's also unrealistic, it would seem to me, to assume they will all be good, 100 percent.

Mr. CLARKE. As I say, that's a subject of debate. To answer your first question, we have not been resistant to the notion of building reserves. What we have been resistant to is the notion of mandated reserves at particular percentage levels.

As the date in my written statement and those of the other regulatory agencies indicate, there has been a substantial buildup both of equity capital and reserves. I think your chart up on the wall

bears that out, too. That has been, in part, because of encouragement from all three bank regulatory agencies, particularly to banks that have large international exposures, to build up those reserves.

The CHAIRMAN. Well, that's right. There's no question about that and I'm delighted that you stress that point. But, of course, that buildup was also in response to the recognition that these loans were not as sound as they would like them to be and that there might very well be a necessity for recognizing that they would have to be paid off at less than par.

My time is up. Senator Garn.

Senator GARN. Thank you, Mr. Chairman.

Mr. Seidman, you and I and the other regulators have had many discussions about OMB's efforts to include the regulators in their antideficiency act and the Gramm-Rudman-Hollings Act. I think you remember several times in this committee forum I have said how I didn't even understand these efforts. At the very time when we needed help for the insurance funds, it made no sense to me at all to see OMB getting involved and reducing the availability of those funds, especially when they are not taxpayers' money. There is still great misunderstanding about this, because many people think somehow these funds are taxpayers' money. So I want to state again very clearly: The FDIC fund and the FSLIC fund are not taxpayers' funds. They are premiums paid by the member institutions to insure their deposits.

OMB INVOLVEMENT

Could you elaborate on the constraints that OMB wishes to impose under the antideficiency act?

Mr. SEIDMAN. I can first by illustrating, Senator—and thank you for your statement. When they indicated that Gramm-Rudman would be applied to us, we were not clear whether legally it could be, but in the spirit of the new law we agreed to comply.

One of the reasons that our examination staff has not been expanding as fast as we would like is that we had to put a hold on hiring during that period. So we are behind in examinations just from that alone.

Second, I think the record will show that since OMB has had control over the Federal Home Loan Bank Board, they have numerous occasions prevented the Bank Board from hiring additional examiners, particularly during the period when the thrifts were undertaking activities that were in part responsible for breaking the fund.

So I think there is ample evidence in the record that OMB really should not have control over these funds. The key to our management is speed and flexibility in acting with failed banks and in moving to get examiners. Until the record shows that we're incompetent to do that—and I don't think it does—it seems to me that it was unwise of them after some 35 years of having a statute on the books to suddenly decide they wanted to apply it to us and to the Comptroller's office and others.

Senator GARN. Well, they try to say that all they want is information, that all they need to know is how your agency is run. I

think it's ridiculous. I have never been involved with a battle with a Federal agency in which I so totally fail to understand its point of view, particularly in the middle of a difficult time for the insurance funds, and when the chairman and I and other members of this committee keep asking why we don't have more examiners, why we aren't keeping on top of this. In the face of all this, OMB wants to put the screws on private funds that are not taxpayers' money and prevent us from doing something. It makes no sense to me at all.

Mr. SEIDMAN. Thank you. I'd just like to add for the record that since I have been chairman, we have given OMB every piece of information they have requested. We have not denied them any information and we've given them a lot more besides that.

So I don't believe they can take the position that they are not fully informed.

Senator GARN. I would assume, Mr. Johnson and Mr. Clarke, that you agree that OMB should not be involved?

Mr. JOHNSON. Of course, OMB isn't involved in the Federal Reserve budgetary issues and our decisions on examiners. We think that's a healthy matter. So, yes, I think the other agencies should be independent from their oversight also.

Senator GARN. Mr. Clarke.

Mr. CLARKE. Yes, sir, I agree.

Senator GARN. Mr. Seidman, could you expand your comments on your current capital forbearance plan? How does it compare with forbearance proposals in some of the FSLIC recapitalization proposals?

Mr. SEIDMAN. Let me tell you where we are in forbearance. We have decided that as a guiding principle we ought to look at protecting the banking system and the insurance fund by forbearing with respect to banks that have impaired capital if those banks are appropriately managed and if they have a reasonable plan for recovery.

So in those cases, instead of ordering a cease and desist order which may eventually close the bank, we have agreed to forbear and not impose such orders.

Now we did that initially just for agricultural and energy banks and only for banks with over 3 percent capital.

We now have decided that we ought to use our guiding principle as our overall method of approaching the problem and not restrict the policy to just energy and agricultural banks. Other banks should be included if they are having problems because of the economy and if, in our best judgment, the bank can recover.

The rules in the forbearance bill in the House are mandatory rules that take the professional supervisory judgment out of whether or not it is appropriate to forbear. I think that that is a formula that is unworkable and could lead to very unfortunate results.

Senator GARN. Thank you.

The CHAIRMAN. Thank you, Senator Garn.

Senator Sanford.

Senator SANFORD. Thank you very much. I apologize for being late and missing your words of wisdom, but I'll read them very carefully.

I have one or two questions—we hear a great deal of talk about the competitiveness of U.S banking and competitiveness is clearly one of the things that we're concerned with as we attempt to design new banking legislation. Are our banks far behind in world competitiveness? Is there great danger that will be overtaken by some other country's banking institutions?

Mr. JOHNSON. Are you addressing that to all panel members?

Senator SANFORD. My question is probably best directed to you, Mr. Johnson, since it is based on remarks in your testimony.

U.S. COMPETITIVENESS IN WORLD BANKING

Mr. JOHNSON. OK. Well, first, I think U.S. banking organizations have been on the leading edge of competition for some time but have seen their position erode as international financial markets have opened up, and, of course, alternatives have developed to banking functions domestically.

As I pointed out in my testimony, one of the factors that I think has harmed the profitability of banking organizations over the last several years has been the period when you have had deregulation on the liability side of the balance sheet where banking organizations had to pay more for deposits, but they have not had the flexibility on the asset side to diversify into activities that are not highly risky in terms of the safety and soundness of banking, and they have not been able to achieve the diversity benefits and the activities that would allow them to compete both domestically and internationally with other types of financial institutions that can issue commercial paper and take a lot of the short-term lending market from the banking system, that can offer money market mutual funds and so put pressure on the deposit side and, of course, internationally you have a number of banking organizations in various countries who do full service financial services all the way through complete investment banking and even some in the commercial activities.

I'm not saying that I fully support that, but I'm saying that——

Senator SANFORD. Can U.S. banks do that abroad?

Mr. JOHNSON. They can to some degree do what the banking authorities in foreign countries allow if we think it's within the realm of safety and soundness for the banking system. But I think what I'm mainly talking about is foreign competition in the United States, other foreign banks having banking subsidiaries in the United States.

Of course, we still concern ourselves with their banking capital and the other types of safety and soundness issues with U.S. bank subsidiaries abroad. So I wouldn't say that we——

Senator SANFORD. Do you have adequate authority to regulate foreign banks doing business in the United States?

Mr. JOHNSON. Excuse me?

Senator SANFORD. Do you have adequate authority to regulate foreign banks operating in the United States, especially in relation to their capital requirements?

Mr. JOHNSON. Foreign banks in the United States are treated just like U.S. institutions. Of course, we are working—one problem I think is that we don't have complete authority over the parent

companies' balance sheet in terms of the standards that are applied there. So I think for that reason we have sought with the Bank of England and we are seeking with other banking authorities abroad, as well as the other banking agencies, a standardization of capital requirements that would allow parent companies to have the same type of capital standards.

Senator SANFORD. Do you think there's any realistic chance of doing that, for example, with Japanese financial institutions as they attempt to establish a more dominant position in the world? Will Japanese financial institutions be willing to cooperate in say, a standardization of capital requirements?

Mr. JOHNSON. Well, I think it is—right now there is a good deal of disparity in the types of capital treatment, but I think that we are making progress. We've had talks with the Japanese banks and we are seeing some willingness to move in this direction. Japanese banks, of course, have many of their capital holdings in hidden reserves in the form of their equity holdings and, of course, they have recently acknowledged that less than 100 percent of those equity holdings should be counted as capital. But we are still moving in the direction of trying to bring them closer to our capital standards and the Bank of England's.

I think we are making progress. I think we've got a good ways to go.

Senator SANFORD. Well, thank you. Our time has expired. [Laughter.]

The CHAIRMAN. Senator Bond.

Senator BOND. Thank you very much, Mr. Chairman, and my sincere thanks to the distinguished regulators.

I would like to follow up on a very interesting line of questioning that my distinguished colleague from North Carolina opened up.

As I read and reviewed your testimony, all three of you seemed to attribute the increase in the number of problem and failed banks to distress in certain sectors of the economy and to banks' loss of many of their traditional activities such as short-term corporate lending.

Now yesterday I had a visit from the leaders of the Missouri Bankers Association who were here and I asked them about the problem in our State, and they said flatly that we cannot continue to have a viable banking system over the long term if we don't allow the banks to compete with those who are competing with them, if we don't give them expanded powers.

I would like to ask each of you specifically, do you agree with that? Are expanded powers part of the long-term safety and soundness of the banking system and what powers do you feel should be included? Mr. Clarke.

EXPANDED POWERS FOR BANKS

Mr. CLARKE. Senator, I am delighted to have a chance to answer that question. I've been saying absolutely yes to that question for a long time to anybody I could find who would sit still and listen.

I think that very definitely the banking industry is going to have to be modernized and allowed to compete and that there are a variety of ways you can go about it. One is to say perhaps banks should

be allowed to engage in additional securities powers and tick off one or two of those, and say perhaps banks should be allowed to sell insurance. But as the financial services industry continues to evolve, I think you're seeing financial services companies become more and more ingenious in developing different types of products which they are offering to the same market that the banks are trying to serve.

I have been trying to suggest that the way to approach this is not to allow banks to engage in one or two or three additional activities but, rather, to come up with a structural system which includes a system of bank supervision and regulation that protects the bank as part of a more diversified company which can engage in virtually any kind of activity. And I believe that can be done. I think we have a responsibility as bank supervisors to do that if you all are willing to let the industry engage in a broader variety of activities.

Senator BOND. And you feel you can segregate it and keep the safety and soundness of the banking entity as efficiently and as effectively as you do now?

Mr. CLARKE. Yes, sir, I believe so.

Senator BOND. Mr. Seidman.

Mr. SEIDMAN. I have discussed this with Mr. Clarke a number of times and the question is which of us is more enthusiastic about his view. So I totally agree. I think that a key question is whether we can insulate the bank for safety and soundness and allow its subsidiary or its affiliate or holding company to operate in other areas. And if you agree—and our professional regulators believe that with appropriate statutory support insulation is possible—then they can engage in significantly broader activities. We have been talking with them. We have reviewed what they need. We have proposals in that area and I think, given the proper weapons, we can have a bank operate in a safe and sound manner even though its subsidiaries or its owners may be in any other business.

I would say with respect to what activities are conducted in the bank in that kind of a situation, I think we would move slowly as the committee proposed, as the chairman had in his original bill, and give the banks four or five powers inside the bank and if that works it could be broadened. But at the same time we could be allowing these other activities to take place in subsidiaries or in affiliates.

Senator BOND. I thank you for your expression of enthusiasm and I hope it's infectious.

Governor Johnson.

Mr. JOHNSON. Well, I think I also agree to an extent that expanded powers are definitely needed to improve the competitiveness of banking organizations. I think that's certainly true for bank holding companies.

I think that I would want to be a little bit careful about the bank in particular. One of the problems I think with safety and soundness issues is whether you want to let banking organizations specifically use insured deposits for riskier types of activities than their traditional lending functions.

So I think that I would be very hesitant to allow the bank in particular to get into expanded powers other than many of its tradi-

tional functions. I think that where the advantages for improved competitiveness can be found are in the holding company subsidiaries and, of course, the Federal Reserve has numerous times advocated expanded securities activities for bank holding companies through holding company affiliates and we have recently decided within the constraints of Glass-Steagall to approve limited securities powers, mortgage-backed securities, commercial paper, and municipal revenue bonds. And, of course, we would continue to look at expanded powers as we looked at the competitive environment to see whether other types of activities might be made available to bank holding companies. But I think we have to be very careful about what we allow the bank specifically to do versus what the holding company can do.

Senator BOND. In the brief time remaining, a very quick question to Mr. Seidman. As Congress has yet been unable to do anything to recapitalize FSLIC, there is a growing concern that FSLIC will not be able to handle it within the plan outlined by the Treasury. There's talk of dipping into the taxpayers' pockets. There's also talk about a merger with FDIC.

Would you care to share any views on what that would do to the soundness of banks and the FDIC?

Mr. SEIDMAN. It's clear to me from the size of the problem that FSLIC has financially that our fund is inadequate to handle it, even if it were appropriate that it be assigned that duty. I don't think it is appropriate, but clearly we are not financially able to handle the kind of problem they have. So they have to do some kind of recapitalizing even though there might be some relationship between our organizations on a long-term basis.

The CHAIRMAN. I want to thank my good friend from Missouri for the questions he asked with respect to the new powers for the banks.

Of course, as you know, I share the enthusiasm that you folks have and I did introduce a bill providing some of those new powers, as you said, Mr. Seidman.

The whole purpose of the moratorium—and believe me, that's not going to be extended—the whole purpose of the moratorium was to give us a chance to do this on a coherent basis with the country as a whole so that there wouldn't be a piecemeal action with 50 States having 50 different rules and with the regulators also having different approaches.

It seems to me we should do this. It's up to Congress to do it. We have 8½ months now in which to act and I hope that we can act.

Senator GARN. May I just interject that once more all of us heard the chairman say the moratorium should not be extended. I want to make sure that's spread across the record.

The CHAIRMAN. I've said that over and over again.

Senator SANFORD. Mr. Chairman——

The CHAIRMAN. You stuck with the 5 minutes, so go ahead.

Senator SANFORD. I just wanted to ask one question following up Senator Bond's question.

I was rather taken aback by "engage in any kind of activity." What do you mean by that, Mr. Clarke?

Mr. CLARKE. Senator, I agree, by the way, with the comments that have been made about the extent to which insured deposits

should be allowed to fund these various activities. I think the notion of putting them in either subsidiaries of holding companies or subsidiaries of banks is the way to do it. If you accept the argument that there is a way to insulate the bank from abusive transactions, from lending too much money to affiliates, from whatever other evils the regulators or others may perceive are there, then arguably it doesn't make a whole lot of difference what the parent organization or any of these other affiliates that are precluded from abusing the bank do.

Senator SANFORD. Commercial operations, automobile agencies?

Mr. CLARKE. Yes. I recognize that that's a fairly dramatic step from where we are right now, but I'm saying that, intellectually, if you buy the argument that you can protect the bank, it becomes very difficult to say that you shouldn't allow financial services companies to engage in a pretty wide range of activities.

The CHAIRMAN. Governor Johnson, as you know, one member of this committee is Senator Phil Gramm and the book on Gramm is that he is very smart and very conservative and very much against unnecessary Government interference anywhere. Now he introduced a bill, which I supported and became an amendment, which we failed to get the committee to adopt to force bankers to reserve more against their troubled international loans.

And in doing that, in supporting Mr. Gramm on that, I said:

> Once banks are better reserved against these loans, then they become more willing to trade such loans at less than their face value. Over time, this could improve both the safety of our banks and lessen the debt load of the debtor nations.

Now the Federal Reserve opposed that proposal and I notice that Mr. Clarke in his statement also made it very clear that he opposed the proposal. As we all know also, only yesterday Citicorp announced it was establishing the type of reserve Senator Gramm and I wanted. It was doing so, said Chairman Reid, "To respond to initiatives being undertaken by various countries to resolve their external debt difficulties."

Bank analysts were almost unanimous in praising the Citicorp decision because "it would adjust financial statements to more accurately reflect economic reality."

In commenting on that, the American Banker and the Wall Street Journal and the New York Times all indicated that while some strong banks would be able to follow and probably would quickly follow what Citicorp did, that many, many banks would not because they just can't do it.

Now what Senator Gramm and I introduced wouldn't mandate they do anything that's impossible. We gave them a great deal of time. We gave them 10 years to adjust to a percentage of their LDC loans.

FED OPPOSED TO MANDATING RESERVES

Why has the Federal Reserve Board been so adamant in opposing our legislation to require banks to reserve more against their troubled loans? And would it reconsider that position in light of the Citicorp decision?

Mr. JOHNSON. Mr. Chairman, I don't think our position has really changed on that. I think, like yourself, though, we feel very

strongly that banking organizations should add substantially to their capital to provide a buffer against added risks to the loan portfolios.

I think where we would have a problem—and, of course, we're working within legislation provided us to encourage banks to add to their primary capital to try and deal with problem assets.

But I think that actually mandating a certain amount of reserving against these loans is a problem for us because it becomes very difficult to determine exactly what the nonperformance of these assets are going to be. So I think what would be a better approach would be to continue to encourage banks to add to their capital reserves but without knowing specifically what particular loan assets are going to go bad, it's very difficult to specifically assign loan loss reserves.

So I think that our view is that we want to continue to encourage additions to capital to provide a buffer against this, but I'm not sure that we would want to say that you put a large portion of that necessarily into loan loss reserves, especially if those loans are still performing.

The CHAIRMAN. Well, of course, the addition to capital is fine and I favor that very strongly and I would push that hard. But that is general. And for some banks you need a certain percentage of capital and other banks it depends on to a considerable extent on the quality of their assets, on the quality of their loans.

Mr. JOHNSON. Yes. I think that's right.

The CHAIRMAN. And if they are heavily into Third World debt, it would seem sensible that their reserves—not their capital necessarily—their reserves against those specific loans should be substantial.

Mr. JOHNSON. Well, I think there is an issue that if the risk of certain loans continues to grow in terms of classified assets, there might be some reason for banks to want to set aside specific reserves and deduct some portion from capital.

But I think that until you specifically identify those problem assets it's better to add to general capital reserves because—I mean, we would certainly require reserving if we saw an impairment to the value of those assets. But as long as those loans are performing, as interest payments are being made and those debts are being serviced, I think the best way to go about it is general additions to capital.

The CHAIRMAN. Well, let me get at that in a little different way. Starting with Mr. Clarke and go across and if each of you could respond briefly, in my opening statement I explained my general misgiving about the accuracy of the capital data your agencies have provided the committee. I specifically mention my concern about whether the Third World loans of the larger banks are appropriately reflected in the capital data you provided. I appreciate the effort that you and your staffs have expended assisting the committee, but we need to go one step further.

It seems to me that Citicorp is facing realities and is making the hard decisions that have to be made. Reserving about 25 percent of their Third World debt is probably about right, given the prices for such debt in secondary markets and the very limited nature of

those markets. The agencies have to face the same realities and incorporate them into your capital estimates.

Now tell us, what is the true capital position of the 10 largest U.S. banks? Is it 5 percent, 4 percent, 3 percent? What is it? And let me—well, go ahead—true capital position based on recognizing the full realities.

Mr. CLARKE. Mr. Chairman, I think you have laid out why it's impossible to deal with that.

The CHAIRMAN. It's not impossible. Let me just say, I appreciate that it is very difficult for you. It's a very tough question. But I'm including the off-the-book risks. I'm including the LDC debt. I'm including taking all of that into consideration. Can you give us something closer than simply the assumption, which we make really when you say they've got 6 or 8 percent capital, that their loans are all good at par?

Mr. CLARKE. Then you would have to tell me what adjustments should be made to capital for each of the various risks that you've identified. It seems to me that it is incorrect to assume that because one institution elected to reserve a particular amount against its portfolio, for its own internal corporate reasons, that that the same number should be applied to everybody else's portfolio. Before you could adjust any bank's capital ratio to determine what the true capital is, as you describe it, it seems to me that there have to be some assumptions and definitions.

The CHAIRMAN. Well, I hope all three of you will give consideration to the following then. I'd like to make a request that you provide us with estimates of the true capital position of the 10 largest U.S. banking organizations taking into consideration 25 percent of their Third World loans, examiner-classified assets, and all off-balance sheet items. And where you may have to survey the banks, obtain a complete accounting of all off-balance sheet items and anything we can do to assist you in doing that we'll be happy to do. But could you do it to that extent?

Mr. CLARKE. I think we can, Mr. Chairman, but when you talk about true capital, are you talking about equity capital or about regulatory primary capital? There are a number of different ways to define capital.

The CHAIRMAN. Well, do the best you can with it. [Laughter.]

Mr. Seidman.

Mr. SEIDMAN. I'd like to comment, starting out with the fact that all Citicorp did was to move something from down in equity capital up to reserves. Now as far as primary regulatory capital goes, they didn't do anything. So that the actual amount of primary capital; which includes reserves, is the same as it was before they undertook that transaction. They simply moved something on the balance sheet from equity down below liabilities to reserves up above.

And let me point out that before we give them too many medals for heroism, they are going to charge their reserves with far lower amounts in the future because their reserve is now higher than anybody else's in the business. So, their profits are going to be much higher in the future because of the transaction that they just undertook. They took a very large loss now and if you will look at their own forecasts you will see that their profits are going to be very much higher.

The CHAIRMAN. Well, there's nothing wrong with those profits, is there?

Mr. SEIDMAN. There's nothing wrong with it. I simply say——

The CHAIRMAN. It's more accurate, too, isn't it?

Mr. SEIDMAN. They have the benefit of a good old American practice of taking a very large loss so they can show better profits in the future. I am not criticizing them. I think they did the right thing. I'm just simply pointing that out.

The CHAIRMAN. Well, John Reid wanted something to get out from under the shadow of that Wisconsin native who preceded him. He was born in Appleton, WI.

Mr. SEIDMAN. Well, Wisconsin produces great men. [Laughter.]

The CHAIRMAN. Joe McCarthy was born there, too. [Laughter.]

Mr. SEIDMAN. I think the market is going to find it irresistible to follow. The other banks are going to look at what Citicorp did and they're going to see that by taking this one-time loss and setting up the reserves which we're all enthusiastic about, they're all going to show better profits in the future.

The CHAIRMAN. They can't all take that one-time loss without a terrific hit. Could Bank America do that?

Mr. SEIDMAN. That's true. They each have to make a decision based on their own situation. But they are not changing their primary capital for regulatory purposes. Whether you have it up here or down below, it's the same. So I think—perhaps I shouldn't stick my neck out, but I would predict that others are going to find it rather attractive to do the same thing, which goes to the point that the marketplace is working and we won't have to be ordering them to set up these kinds of reserves.

The CHAIRMAN. I can't think of a better situation than the banks being able to tell you the truth and then make more money out of it.

Mr. SEIDMAN. I agree with that. I totally supported what Citibank did, assuming that they will continue to pursue collecting those loans on the same basis as they have before and they have stated that they will.

The CHAIRMAN. Governor Johnson.

Mr. JOHNSON. The only thing I would add to that is that certainly if Citicorp thinks that they are going to realize that degree of losses over time it was appropriate for them to set aside part of their capital in additional reserves. I think that because they have taken this step, of course, they've gotten special tax consideration for this treatment of provisions.

I think there is a question about whether those loans are going to continue performing over time. Right now most of these loans are performing. They're assuming that they may not continue to so perform. But if they continue to perform, which I would hope they would, then I think there's some question about the specific tax accounting in that particular provision because they do get a tax offset to their projected future earnings. So I think there's a question there.

I think it depends on whether they actually take those losses as to whether they get the tax benefits that are projected and that depends on whether those loans perform over time.

The CHAIRMAN. Before I yield to Senator Garn, let me just say we have an unusual situation here on banks' taxes. Banks' taxes are about 1 or 2 percent of their real net income, as we all know. Banks just get away with murder on that. If banks had to pay 4 or 5 percent, it would be a new day. Maybe we could balance the budget.

Mr. JOHNSON. Well, they might say they wanted to receive some interest on their reserves so that they could pay more. That's one thing I think they would say.

But on your question about this 25-percent provision and what that would do to capital, I think we've looked at similar percentages like that and I don't want to indicate by any means that I think that this is something that every bank should do. I think that depends on the quality of their portfolio of assets as to whether they would want to take a measure like this.

But I think if you were to use that kind of a measure for the major banks, you would find that even if you adjusted for 25 percent loss provisions you would find that capital ratios of the major banks adjusted for that are still higher than the levels that existed in 1982. I think that's in general—there may be some specific banks that don't improve relative to 1982, but I think that so much has been added to capital over the last several years that even adjusting 25 percent against that you would find that capital in general has still increased over 1982 levels to a significant degree.

The CHAIRMAN. Senator Garn.

Senator GARN. Thank you, Mr. Chairman.

To finish up in this area of capital adequacy, let me sum up my position and see if you gentlemen agree.

It's certainly evident here that everyone who has spoken on this side of the table and on that side agree that capital needs to be increased. I guess the next question then is how do we do it? I personally do not think that mandating additional reserves across the board for all banks makes sense from two standpoints.

First of all, it isn't just LDC debt that is a problem. Chairman Gray is going to talk about S&L's in a little while. I don't know too many S&L's that have loaned money to the various countries in Central and South America. They've got a lot of bad loans in some mushroom farms and all sorts of other things.

The point I'm trying to make is, in our current financial system across the board, there are a lot of different reasons why financial institutions have some difficulties and have bad loans—a very wide variety. So for Congress to pick a number and say we want to mandate a certain percentage for all banks by a certain date is typical of Congress overreacting to a situation. I used to use the phrase when I was mayor of Salt Lake City it might be nice and convenient and efficient to mandate that every man in Salt Lake City wear a size 42 suit, but obviously there are some people that are 50's and 48's and some that are 36's and different sizes. So the 42 would fit some, but it wouldn't fit everybody. That's the way I look at mandated reserves. For Congress to mandate a specific figure by a certain period of time would fit some situations and work very nicely, while in others it would not, and in some cases it would cause difficulty.

That's why in my opening statement I made the comments about how I was pleased that banks were taking steps, and that capital had increased. I certainly think we in Congress should encourage that and you regulators should do it. You should do some very tough jawboning in your examinations and you should certainly let these institutions know when you think they are not doing what they should be doing. And in light of this voluntary action taking place—and I would expect more of it—it seems to me that mandating particular figures is not the way to go.

Is that a summation of your views?

Mr. CLARKE. Yes, I would certainly agree with that.

Mr. SEIDMAN. That is our view, Senator.

Mr. JOHNSON. Yes.

EFFECTS OF TOO MUCH CAPITAL

Senator GARN. Now let me take it one step further. Everybody agrees that increased capital is necessary. Is it possible to require too much capital and, if we do, what does that do in the area of competitiveness and safety and soundness if we require too much capital? Admittedly, there isn't enough now, so I don't want to be misunderstood on that point.

Mr. JOHNSON. I was going to add, I wish that was our problem. I don't think that's the environment we live in today.

Senator GARN. It definitely is not.

Mr. JOHNSON. But I think that obviously if the quality of assets were to improve dramatically, I think that continuing to add to capital levels would not make nearly as much sense as when problem assets are growing.

But I can't speak directly to exactly what the optimum capitalization level of the banking system would be. I think it is something that depends—why you need flexibility—I think it's something that is variable from bank to bank depending on what the examiner finds when he goes in and sees the quality of that asset portfolio.

I would like to foresee a day when problem assets would shrink and that we could stabilize capital requirements and I think that, of course, that's true for individual institutions who have not had these problems. But I guess it is conceivable certainly that you could have too much capital. I just don't think that's the problem we face today.

Senator GARN. Mr. Seidman.

Mr. SEIDMAN. I believe that in the long run requiring too much capital would hurt the profitability of the industry. In other words its return on capital would be hurt. If a bank doesn't have a competitive return on capital, it will have difficulty in raising capital in the marketplace and competing. So in the long run, you will make the industry less competitive, less prosperous, and weaker.

So there is a danger in requiring too much capital and forcing the industry to be noncompetitive particularly in the international area.

Senator GARN. Well, it is hypothetical at this point. I wish we were dealing with that problem rather than the one that we are.

Mr. SEIDMAN. If I could just add, and the marketplace, is judging this all the time. How much capital there is, whether it's enough,

and whether it's too much. That's one of the major factors they look at in pricing stock.

Senator GARN. Mr. Clarke.

Mr. CLARKE. Just two comments, Senator. I do agree with you that we're not in an environment today of having too much capital. But if you do require too much capital, there is also the risk that in order to obtain a decent return on capital banks may try to move into areas of greater risk where they can get higher returns. So you really defeat the very objective you're trying to achieve.

The other comment is that that's the very purpose in having the risk adjusted approach to measuring capital adequacy, to try to tie the amount of capital more to the level of risk in the individual bank's portfolio.

I don't think there's anybody smart enough to tell a bank precisely how much capital they ought to have. We could take a poll this morning and come up with as many different numbers as we asked people. But I do think that we're not at the point where we should be telling all the banks in the system that they should stop raising capital.

Senator GARN. You're amazing. You led right into my next question without even knowing what it was going to be.

That was to ask you about the risk-based capital proposal that you have been trying to come to grips with and reach a consensus on. My understanding is that the proposal you're working with would result in increased capital requirements for banks, but if the risk-based calculation produces a lower capital requirement than current law, then current law would apply. Is that correct?

RISK-BASED CAPITAL

Mr. CLARKE. That is the one area where there may not be total unanimity yet among the three of us, although it's something we've talked about a great deal. It seems to me that if we do become comfortable with the concept of risk-adjusted capital as the way to measure capital adequacy and if based on a risk-adjusted formula a bank's capital requirement is lower than its present capital and it makes such a request, there's no reason that we shouldn't allow it to drop below some minimum level, below the 5.5 percent primary capital level that exists today, for instance. And there is flexibility built into the proposals out for comment from all three agencies that would allow that to be done.

Senator GARN. Well, it would make sense to me to have it work both ways. If it can only go up, to penalize those who are in more risky ventures, it would seem to me the very prudently run organization ought to benefit from that and be able to have less.

Mr. CLARKE. The expectation is that there would ultimately be a range—again, because I don't think we can tell a bank precisely how much capital is just right—within which most banks would be expected to operate, and we would ultimately indicate to banks what that range is. And if they tailor their portfolios so that they could drop below that range, then they would be allowed to do so.

Based on models that we have run, I believe somewhere between 120 and 130 national banks would be required to raise additional capital if the number were set at 7 percent, for instance. So most of

the banks today are operating within the ranges that we're contemplating.

Senator GARN. Senator Chafee, do you have any questions you wish to ask before we go vote?

Senator CHAFEE. I've just got a brief statement I would like to put in the record now. Thank you.

Senator GARN. It will be included in the record.

STATEMENT OF SENATOR JOHN H. CHAFEE

Senator CHAFEE. Mr. Chairman, the question of the condition of federally insured institutions is certainly a timely one, especially in light of the bill the Senate just sent to the House involving FSLIC recapitalization. I understand that the House Banking Committee did not reach a consensus last night on a course of action, so I am hopeful that today's testimony by Mr. Gray and others will be a useful spur and that we in Congress can resolve this matter as soon as possible.

I also see these hearings as the kickoff on this committee's review of the broader question of the future system we wish to have in this country in the banking/financial services arena. There are many pieces in that puzzle, and the more quickly we start to address the issues the sooner we can come to a meeting of the minds in this committee.

Senator GARN. Mr. Seidman or Mr. Johnson, do you have any comments you wish to make on risk-based capital?

Mr. SEIDMAN. Well, we do have, I guess not, a theoretical difference but a practical difference among the agencies as to at what point we would make risk-based capital the standard and eliminate the standards that we have now.

I think the people in our agency by and large would like to continue with both standards for a while and look at it and see how it works before we go to what I think is a theoretically correct answer. If the risk adjusted capital ratio requires more capital, capital goes up, and if it requires less, capital goes down. We just think that that's not probably the way to start it.

Mr. JOHNSON. I think we would see it in a similar way. I think our preference would be to start off with this system somewhat in tandem but I think we visualize eventually going to a single risk-based standard at the Federal Reserve.

I think that as a practical matter, what you would probably find in applying a risk-based standard to the banking system would be that those banks in general who probably could go below the current minimum are already well capitalized above the current minimum standard today.

So that, as a practical matter, most of those banks are already well capitalized above the minimum standard that's imposed so that even if they were able to go below, they probably would choose not to, at least looking at their history. They would remain capitalized above that.

For many of the larger banks with very heavy off-balance sheet items and less liquid assets, you would probably find—and this is most of the larger banking institutions—I think you would find that even if there were no minimum or the current minimum

wasn't applied, under a pure risk-based system they would all have to add capital to their portfolio given the risk adjustment by adding in large off-balance sheet items and taking into account some of the riskier loans in their portfolio.

Senator GARN. If the United States and the United Kingdom entered into a joint risk-based capital agreement about which there's been some talk, wouldn't this give the Japanese an even greater competitive advantage than they already have with their lower capital requirements? Wouldn't it also provide less incentive for the Japanese to join such an agreement if we proceeded only with the United Kingdom?

Mr. SEIDMAN. Well, the supervisors will be meeting in June to discuss that. The hope is—and it is the hope of the supervisory people from all of the countries—that we can reach an agreement. I think the supervisors from all the various countries, including Japan, have indicated they want to reach an agreement. That's not the same as getting it done, but the objective is to try to.

Senator GARN. Well, I've had some conversations in Tokyo, Japan a month ago that didn't indicate that necessarily the Japanese were going to be as cooperative as I would like them to be. I do think that all of them need to be involved or you do produce some additional competitive advantages for Japanese banks. I don't think they need any more competitive advantages right now. We're giving them enough as it is.

Mr. SEIDMAN. We all agree with that I'm sure.

Senator GARN. Gentlemen, we will stand in recess until the chairman returns from the vote.

[Recess.]

The CHAIRMAN. The committee will come to order.

Mr. Seidman, the supervisory information review on page 15 of your statement concerns me very considerably. I'm astonished to learn that the FDIC is averaging one examination every 4 years for satisfactory banks, one every 2 years for marginal banks, and one every 20 months or so for problem banks.

EXAMINER REDUCTIONS AT FDIC

This is wholly unsatisfactory, in my judgment. I've been concerned about the FDIC's policy of examiner staff reductions since they were first announced but what I truly did not and still do not understand is why, when problem bank volume began to rise after 1981 the FDIC continued its policy of examiner staff reductions.

Why was that permitted to take place?

Mr. SEIDMAN. Well, as you know, Mr. Chairman, I was not at the FDIC at that time. I was happily out in Phoenix being dean of a business school, and I can't answer that question.

I can tell you that immediately on my taking this job it was clear to me that we were going in the wrong direction and we have had a crash program to hire additional examiners. We expect to hire 600 examiners during this year. We are badly behind and I cannot controvert your statement. We simply misjudged the marketplace, I gather. But, by the end of this year, we plan to be up to at least 2,100 examiners.

The CHAIRMAN. Well, I just wonder about that number. The important thing is the number in relationship to the size of the job, isn't it?

Mr. SEIDMAN. That's correct.

The CHAIRMAN. And, of course, you now have higher deposits than ever.

Mr. SEIDMAN. Yes, sir.

The CHAIRMAN. And the problem situation, as I say, is very bad. On that basis, it doesn't seem to meet the need. Are you having trouble hiring examiners?

Mr. SEIDMAN. We have been doing better recently since we got some exemptions from OPM to allow us to make offers to good students without having to go through a very long procedure. So we are doing well. But these are all students that have to be educated during the examination process when they come with us. So it means that the fact that we have increased the number does not give us the capability we had.

I would point out that we are doing a new program to hire private sector CPA's to help our examiners. We have run that experimental program now for about 3 weeks and we expect that if the program proves successful—and it looks like it will—that we will be able to supplement our examination force with private CPA help until we can build our own staff.

The CHAIRMAN. Mr. Seidman, on page 18 of your statement you mention the possibility of large shifts of institutions from FSLIC to FDIC insured status. How many actual applications to shift from FSLIC to FDIC do you have pending at the FDIC?

Mr. SEIDMAN. Right now, as of about 3 days ago, we had 14.

The CHAIRMAN. How many?

Mr. SEIDMAN. Fourteen.

The CHAIRMAN. How does that compare with your experience over the time you've been there?

Mr. SEIDMAN. It's somewhat higher. We also have had, however, a very large number of inquiries, maybe up to 100, from institutions or their counsel with respect to what they have to do to apply. So there's a substantially greater interest out there, but I don't know whether that will turn into applications or not.

The CHAIRMAN. Now, Mr. Johnson, in comparing the examiner staff at the Federal Reserve for banks—not bank holding companies—banks with others, I've made the statement that these other institutions have about half the bank examiners that the Fed has on the basis of comparing the size of the problem with respect to dollars.

So let me ask you, could the Federal Reserve meet its bank examination responsibilities with only half of its present staff? What, in your judgment, would be the effect on bank soundness over time if you did?

Mr. JOHNSON. Well, first, I don't think we could. I think that we are able to intensify—as a matter of fact, I think this chart on examiner man-hours per million dollars of banking deposits shows us rising and, of course, if you look at that chart I think you'll find that even given the resources we have it may not be adequate under the conditions that exist today. So I certainly wouldn't want

to cut back on that and I think that we are continuing to require additional resources to intensify our examination process.

Of course, I think that we're finding that asset quality is the major problem with the banking system and that that's been the major problem behind profitability and that you can't really get a good grasp of that unless you've been inside the bank looking at the loan portfolios that they have.

The CHAIRMAN. Well, my feeling is that the Fed has not got an excessive number of examiners. It's about right. Maybe you could use more. But it seems to me your people are working hard. They're at work. They make examinations they can because you have more resources than the other regulators have.

Mr. JOHNSON. Yes.

The CHAIRMAN. I understand Federal Reserve State member banks and national banks which are under the jurisdiction of Mr. Clarke, of course, are similar in average size and operations, but the Comptroller's office on a man-hour to deposit basis has only about half the resources that the Federal Reserve has to do the same job.

What does that mean for long-term national bank soundness, in your judgment? Then I'd ask Mr. Clarke to comment.

Mr. JOHNSON. Well, I don't want to preempt Mr. Clarke's view, but I think that obviously they could stand some more supervisory resources.

The CHAIRMAN. Mr. Clarke.

Mr. CLARKE. Senator, you raise a very important point, but I would like to say that there are two things that have to be considered. One is, we do need more people. There's no question about that. And, as I think you know, we did suffer badly last year with the hiring freeze that was imposed because not only were we not able to hire the people we had projected hiring and begin to train them, but we were not able even to replace the people we lost through our normal attrition.

The CHAIRMAN. Senator Garn was exactly right. That hiring freeze made no sense for you because your work is paid for out of an assessment on the banks that you supervise, right?

Mr. CLARKE. Yes, sir.

The CHAIRMAN. It doesn't come from the taxpayers. It comes from the banks.

Mr. CLARKE. It comes straight from the banks, that's exactly right. And to the extent that we don't spend it, it either gets refunded to the banks or gets held in an account.

The other aspect, though, is that you can't solve bank supervision problems with more people alone. As institutions become larger and more complex, we have to figure out how to work smarter with the number of people that we have. As I indicated in my written statement, we are taking a somewhat different approach from the way we've traditionally examined banks in an effort to make better use of the limited resources that we have.

On balance, I definitely agree with you that we are undermanned, and we are doing everything we can to correct that. It's difficult to do, as you can appreciate, because you can only train and absorb so many people at a time. A lot of our best training is on-the-job training, and if you have a disproportionate number of

people being trained, the trained examiners can't get anything done beyond training inexperienced people.

The CHAIRMAN. Is there action that the Congress could take to cut the restraint you have from the budget on your examining staff?

Mr. CLARKE. A great benefit for us, and something this committee attempted to do, would be to exempt all of the bank regulatory agencies from Gramm-Rudman. While it was true that there was no sequestration this year, and we were very fortunate in that regard, we live with the constant threat that next year or the year after there will be one.

The CHAIRMAN. There could very well be one this year or next year.

Mr. CLARKE. Sequestration in some years pulls an agency from one direction to the other and makes it very difficult to do any planning.

The CHAIRMAN. So if Gramm-Rudman were applied to you and your funds were sequestered, you not only would be frozen but you would be reduced in the number that both the FDIC and the Comptroller could have of examiners. So most of our banks, because you two gentlemen regulate the vast majority of our banks, would therefore have even less examination. There would be less safety and soundness, right?

Mr. CLARKE. You asked what kinds of things Congress could do. There is a serious problem in the bank supervision business—it's not peculiar to bank supervision, it's true in Government everywhere—but it's especially true in bank supervision, which is essentially a professional job requiring people with experience and good judgment. It's very difficult to retain such people long term under the pay cap restrictions that we are currently faced with.

Once again, my judgment is, because we are not dealing with taxpayers' money, because we're dealing with banks' money, we ought to have some latitude in the extent to which we can pay our more senior people and offer young people who are coming into the force a promising career long term, not one that's necessarily equal financially to private industry because I don't know that the Government should ever expect to equal private industry in that regard. But I think the pay gap has gotten so big between private industry and Government service that it is putting a real damper on our ability to attract professional people.

The CHAIRMAN. Before you gentlemen leave—and I want to thank you very much for your testimony—I think you should all be very mindful of the fact that this country is in debt as it has never been in debt before, not only the Federal Government which we all know, of course, but the consumer, the corporations. That debt is terrific. And come the next recession, the effect could be just devastating.

So it seems to me very clearly we need more capital, we need more reserves, and we need more examination resources for you gentlemen. I think you're all doing a fine job and we appreciate it very much. We appreciate your testimony. Thank you very much.

Our next two witnesses are the Honorable Edwin Gray, Chairman of the Federal Home Loan Bank Board; and the Honorable

Elizabeth Burkhart, member of the National Credit Union Administration Board.

Mr. Gray, we're happy to have you before the committee. The last time you were before the committee I said this was your last appearance and you've done a fine job and that we were going to miss you and so forth. I'll say that again. I hope you come back many times in the future.

Mr. GRAY. Thank you, I'll come whenever you invite me.

The CHAIRMAN. As you know, we have a time limit and I hope you will be able to confine your remarks to 10 minutes or less. Go right ahead, Mr. Gray.

STATEMENT OF EDWIN J. GRAY, CHAIRMAN, FEDERAL HOME LOAN BANK BOARD

Mr. GRAY. Thank you very much, Mr. Chairman.

Mr. Chairman and distinguished members of the committee, thank you for the opportunity to share with you my thoughts on the condition of the Nation's FSLIC-insured thrift institutions.

Before doing so, I want to thank you, Mr. Chairman, and the other members of the committee, for your understanding of the problems the Bank Board has faced over these past 4 very challenging years. As you know, I will complete my term as a member and as Chairman of the Bank Board on June 30. I've come before this committee many times during these years on occasions such as this. I have sought from the beginning to be candid and straightforward with you about the condition of the industry I regulate, my concerns over time about the deteriorating condition of the FSLIC, and other matters of interest to you.

I and my staff have worked very closely with the committee staff in the hope of achieving needed legislative change.

The Senate did pass significant legislation in 1984, but since it takes two to tango and the House did not choose to follow through at that time, we, of course, are still waiting for congressional action.

Mr. Chairman, I want to thank you very much for your support of my positions on safety and soundness during my tenure. I have been a much tougher regulator than many in the thrift industry would have liked. There is and has been a fashionable notion that thrift regulators ought to be "go-along" guys who either keep their mouth shut about the problems or operate as "good news Charlies" limiting their public and even private utterances to only positives and never negatives.

As a thrift regulator, I have not chosen to be a "go-along" guy, a "good old boy" or a "good news Charlie." I have sought very hard to be a regulator, which is what I believe the Congress and certainly the law want me to be. Not an industry spokesman or an extension of any trade association. I am not nor have I been the property of the institutions I regulate nor should I be.

Some in the thrift industry have long considered the Bank Board as their property and by damn, the regulator had better go along with them if he knows what's good for him. This is an unhealthy notion for the industry and for the Government.

Had I chosen to be popular with the industry I regulate, I would have done virtually nothing in these last 4 years except maintain the status quo which existed when I took office. Think about the consequences of that course of nonaction.

The role of the thrift regulator must necessarily be that of, yes, a regulator. The thrift regulator must stand up to enormous pressures if he or she is to carry out his or her responsibilities to protect the public interest.

I have taken many regulatory actions which have not been and are not popular with some I regulate, but I have not seen my role as that of winning a popularity contest.

Again, Mr. Chairman, I do appreciate very much your understanding and your support of the Bank Board over these last 4 difficult years for the national thrift system and the agency.

TWO TYPES OF THRIFT INDUSTRY

I have outlined for the committee my views about the condition of the industry in the statement I provided. In effect, there are two industries today. One is the profitable thrift industry. The other is the unprofitable thrift industry.

In 1986, the profitable thrift industry, comprising nearly four out of every five FSLIC-insured institutions, earned $9.2 billion. The annualized average return on assets for these profitable thrifts was 1.02 percent. That's around what the commercial banking industry average would probably be. To get the 1.02 percent average, you must recognize, of course, that many of the profitable thrifts had earnings performances much higher than the average, making many thrifts very high earners by any standard.

The net income of profitable thrifts the year before—that is 1985—was $7.3 billion. This amounted to a return on assets for the year of 0.88 percent. The profitable thrift industry is doing very, very well.

What about the other thrift industry, the unprofitable thrift industry? Just the opposite is the case. In 1986, roughly one out of every five thrifts was unprofitable. These thrifts, holding $242 billion in assets, or slightly more than 20 percent of the assets of the entire industry, lost $8.3 billion and suffered from a negative return on assets for the year of 3.80 percent. Again, this compared to a positive return on assets of 1.02 percent for the profitable thrift industry in 1986, as I've said.

Now if you subtract the $8.3 billion in losses of the unprofitable thrift industry from the $9.2 billion in net income earned by the profitable thrift industry, you will find only about $900 million in earnings by the entire thrift industry itself. But I don't think that that's the way to look at it. It really doesn't tell the story, again, because there are two thrift industries, each performing very differently.

Our proposed recapitalization of the FSLIC is intended to deal with a significant portion of the unprofitable industry which is either insolvent or is on its way to insolvency.

More than 400 thrift institutions are insolvent using generally accepted accounting principles. Our significant supervisory category includes a caseload of 387 institutions with assets of around $138

billion. Unfortunately, as I have explained in my statement, the effects of this state of affairs on the profitable thrift industry are very considerable indeed.

The thrift industry is paying at least $4 billion more than it should pay for funds each year because of the public perceptions of the failing sector of the industry and because of the perception of a weak insurance fund which GAO has now determined to be insolvent.

To deal with this challenge, recapitalization of the FSLIC is a must and the sooner, the better. I have outlined repeatedly before this and other congressional committees for well over a year now the need to recapitalize the FSLIC, and my views on this are well known to all so I won't go into them at this time in this opening statement.

To those, however, who claim that the thrift industry can no longer be viable, that it can no longer compete, that it no longer serves a justifiable public policy purpose, I would answer it's not true. The evidence is just the opposite.

The profitable thrift industry—and, yes, in particular the performance of the profitable thrift industry itself shows that thrifts which are well run, prudently managed, and adequately capitalized can compete effectively and profitably with other sectors of the financial community and certainly with commercial banks.

Indeed, the performance of the profitable thrift industry shows that its very profitability comes largely from meeting its principal public policy mission of financing residential housing. By and large, and as a general rule of thumb, the highest true performers in the profitable thrift industry—that is to say the best earners—are doing so and have continued to do so by sticking to their knitting and doing most of their business making housing-related mortgages.

Mr. Chairman, I would be pleased to answer any questions that you and other members of the committee may have.

[The complete prepared statement of Edwin J. Gray follows:]

STATEMENT OF

EDWIN J. GRAY, CHAIRMAN

FEDERAL HOME LOAN BANK BOARD

BEFORE THE

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

UNITED STATES SENATE

MAY 21, 1987

Mr. Chairman, members of the Committee, thank you for this opportunity to appear before you. Your invitation requests that my testimony provide the Committee with an overview of the current financial condition of the federally insured depository institutions under the jurisdiction of the Federal Home Loan Bank Board. As we are all painfully aware, the condition of the thrift industry is, currently, very much affected by the condition of the Federal Savings and Loan Insurance Corporation ("FSLIC"). In fact, it is my belief, stated many times before Congress, that the very future of the thrift industry will be dictated by the steps we take to revitalize the FSLIC. Therefore, Mr. Chairman, I will summarize briefly the condition of the FSLIC fund before responding to your specific questions.

I. State of the FSLIC Fund

We have arrived at a critical juncture for the FSLIC. The General Accounting Office ("GAO") has found that the fund was insolvent by $6.3 billion as of December 31, 1986, using generally accepted accounting principles (GAAP). (See Exhibit 1.) This insolvency has had the effect of extinguishing the FSLIC secondary reserve. This also has had the effect of reducing the net worth of the thrift industry by over $800 million, because thrifts were previously allowed to carry their portion of the secondary reserve on their books as an asset. The FSLIC's insolvency also has meant that no substantial new FSLIC guaranteed loans will be made by the Federal Home Loan Banks. This is forcing the weakest thrifts to increase further their already excessive deposit rates. This also is increasing these thrifts' net operating losses and is forcing healthier thrifts to bid up their deposit costs. FSLIC insured thrifts already pay much higher deposit rates than FDIC insured institutions because of the weakness of the FSLIC fund and the impact of these "high rate junkies." This excessive cost represents $4 billion annually. The insolvency also may cause accountants to require additional billions of dollars of writedowns by thrifts holding FSLIC notes. GAO made it clear that the qualified opinion it issued on May 14, 1987 to the FSLIC for the 1986 audit of the insurance fund's books was because -- in GAO's words -- FSLIC is unable to carry out its statutory mission, due to its insolvency, and because of the inadequate amounts authorized under the existing House and Senate recapitalization bills. I want to point out that GAO is the entity Congress has assigned to audit FSLIC's books.

Since the insurance fund has well below $1 billion in cash and investment securities, the FSLIC is being largely forced to shut down its case resolutions. Therefore, the ability to resolve many of our most costly FSLIC cases is impossible because resolution would require more cash than we have. Because it is not possible to resolve but the smallest trickle of our significant supervisory cases, their net operating losses are running at over $10.4 million <u>every day</u> -- or $3.8 billion per year. Worse, that rate is growing dramatically. As

the GAO's recent study on forbearance confirmed, delay in resolving FSLIC cases increases losses to the FSLIC. It has become fashionable to describe the FSLIC's insolvency as "technical". I do not know what that means. I do know that FSLIC's insolvency has already imposed very substantial costs on the thrift industry.

While there are significant differences between the Senate and House bills, they both share certain problems that, I believe, imperil a meaningful FSLIC recapitalization.

Congress' own experts, the GAO, have explained that $15 billion in bonding authority is essential. We have made a similar showing to Congress. Investment bankers stressed to the House Banking Committee, in briefings and testimony, that a $5 billion plan would involve unnecessarily high interest rate expenses. The additional expense has been estimated as approximately $2 billion. That expense does not take into account the net operating losses and higher deposit rate expenses (together, these total approximately $8 billion per year, or at least $16 billion over the next two years) that will continue undiminished with inadequate funding. While the Senate's $7.5 billion plan is incrementally better, it will still fall far short of an amount necessary for successful recapitalization.

The primary stated rationale for limits is to avoid an "excessive burden" on the thrift industry. That rationale is unsupportable. First, under the $15 billion plan, the special assessment would be phased-out over 5 years. The special assessment represents 60 percent of the FSLIC's total insurance premiums. Far from "imposing a burden" on the industry, our recapitalization proposal would cut thrifts' premium rate by 60 percent over five years. Second, if the thrift industry is going to recapitalize its insurance fund, then a $5 billion plan is far more expensive, because it would have to be followed by succeeding plans. As the investment bankers have explained, it is far more expensive to sell bonds in this manner. As I have explained, the roughly $8 billion annual price tag guaranteed by delay -- and some $8 billion in net operating losses alone over the coming two years -- also means that the second phase of bonding authority would probably have to be well in excess of $10 billion. I would also like to stress the obvious destructive effect on my successor's ability to plan rationally (even if he were to be able to sell successfully $5 billion in bonds) if he has only two years of bonding authority.

The "excessive burden" argument can only make sense if someone else is going to bear the burden of providing $10 billion or more dollars to the FSLIC. There is only one other source of money -- the taxpayers. In private, some industry executives make no secret that the taxpayers are precisely the folks they have in mind to bear the burden. I hope that

Congress will not fall into this trap. Our $15 billion recapitalization plan can reduce insurance premiums substantially while giving the FSLIC enough funds to resolve promptly its caseload of hopelessly insolvent thrifts.

An integral part of the Bank Board's recapitalization program is the expansion of the FSLIC's existing statutory authority to levy "exit fees" on healthy institutions that voluntarily switch to FDIC insurance during the initial years of recapitalization. The problem of institutions leaving the FSLIC system is ongoing, and unless the Financing Corporation can receive adequate exit fees, FSLIC recapitalization in any form and for any amount will fail to fulfill Congress' intent i.e., it will be neither meaningful nor revitalizing to the FSLIC. Inadequate exit fees will directly threaten the viability, cost, and fairness of FSLIC recapitalization.

Currently, we have express statutory authority to levy an "exit fee" in an amount equivalent to the sum of (i) twice the previous year's regular annual FSLIC premiums paid by the institution and (ii) twice the previous year's special premium assessment paid by the institution. I refer to this as the "two-plus-two" exit fee. Despite urging by the Bank Board neither the House bill nor the Senate bill provide FSLIC with the expanded exit fee authority that is necessary. The Senate bill doesn't address the issue at all. The House bill merely restates the FSLIC's current authority and, worse, requires FSLIC to rebate some of the exit fees it has collected. The current exit fee structure is a vestige from an era when the FSLIC was strong and there were no bonds requiring repayment.

It has been argued on the House side that any exit fee beyond "two-plus-two" would be an excessive burden on institutions leaving the FSLIC system i.e., that the "two-plus-two" formula would require the typical institution to pay an exit fee greater than its entire annual profits. In fact, Exhibit 2 provides the relevant comparison. It shows that the institutions with sufficient capital to meet the FDIC's 6% capital requirements (which are, of course, the institutions most likely to leave the FSLIC first) have an average return on assets over three times greater than the industry average. Even those FSLIC insured institutions with FDIC-qualifying capital between 4 and 6 percent have a return on assets over twice the industry average. For those institutions most likely to leave the FSLIC system the "two-plus-two" formula would represent less than half of one year's after tax profits. Even a "four-plus-four" formula represents less than one year's after tax profits. Moreover, given the lower premiums charged by the FDIC, and the lower interest costs of FDIC insured institutions, a thrift can very quickly -- in just a matter of months -- recover the "two-plus-two" exit fee.

In sum, the institutions likely to leave the FSLIC system can readily afford to pay well beyond the "two-plus-two" formula without experiencing any undue burden. Moreover, any "burden" to those leaving the FSLIC system does not disappear. It simply falls on the rest of the thrift industry, the less profitable portion of the industry least able to bear such a burden -- the portion of the industry left as FSLIC members. The clear implication here is that, in the end, such a burden could ultimately fall directly on the shoulders of the taxpayers, instead of on the shareholders of departing healthy institutions.

Inextricably linked to the inadequacy of the existing exit fee language is the issue of fairness. The richest thrifts will pay a bargain basement exit fee, while the great majority of thrifts will bear the higher costs because they are left behind. As I previously suggested, in the end, this burden will surely be transferred to the taxpayers when public funds are required to ensure the payment of debt service to bondholders to avoid a bond default. In the meantime, many healthy thrifts would already have escaped such a debt service obligation at the bargain basement cost of "two-plus-two".

For all of the reasons set forth above, I continue to urge Congress, now in the arena of a Conference Committee, to remove the "encouragement" cited by Chairman Seidman of the FDIC for the healthiest of the thrift industry to convert to the FDIC -- namely the "two-plus-two" provision in the House bill and in current law. In my opinion, it is neither apropriate to the interests of the financial system nor is it sound public policy to allow FSLIC recapitalization to become a device to allow wealthy institutions out at "super saver" rates while poorer thrifts, and, ultimately, the taxpayers, are saddled with the cost of repaying the interest on bonds outstanding.

I discussed the entire exit fee issue in considerable detail in my statement to the Oversight Subcommittee of the House Banking Committee on May 14, 1987. I call the Committee's attention to that statement.

I would also like to address one purported "forbearance" provision in the Senate bill. The provision barring the Bank Board from requiring, through appraisals or classification of assets, reserves in excess of what GAAP would require is a guarantee of additional and more costly failures. Appraisals and asset classification are not accounting principles, and GAAP does not provide either appraisal or asset classification methodology. The intent of some industry proponents of the provision, however, is clear. It is to forbid the Bank Board to require thrifts to report their true financial condition. The goal of these proponents is to overstate the financial health of sick thrifts. Such purely cosmetic, obviously misleading

reporting is bad public policy. It also will cause a delay in thrifts having to recognize their losses. As I explained, that will delay the Bank Board's ability to take effective supervisory and enforcement measures and will allow inept (or worse) thrift executives to run up massive losses before closure.

II. State of the Thrift Industry

Question 1

Are current levels of capital (GAAP and RAP), including consideration of classified assets adequate? How do current capital levels compare with levels in previous years? What are the current minimum permissible capital levels for FSLIC-insured institutions, and how do they relate to the minimum permissible levels for FDIC-insured institutions?

Answer 1

At year-end 1986, regulatory capital of institutions insured by the FSLIC represented 4.78 percent of the aggregate liabilities of these institutions. The same ratio as measured by GAAP was 4.56 percent at the end of last year. The regulatory ratio rose from 4.56 percent at the end of 1985 and the GAAP ratio rose from 3.29 percent. The 1986 regulatory ratio was the highest year-end ratio since 1980, while the GAAP ratio was the highest since 1981. Both, however, were still well below capital ratios in earlier years, when there was no significant difference between the regulatory and GAAP measures.

During the 1950s and 1960s, the capital/liability ratio for FSLIC-insured institutions had been both more stable and higher than in recent years averaging 7.48 percent and ranging only between 7.92 percent and 7.18 percent. Beginning in the early 1970s, however, the average capital ratio of thrifts began an almost continuous decline, dropping from 7.66 percent at the end of 1969, to 5.92 percent at the end of December 1979. This reflected a drop in thrift profitability, and therefore a reduction in retained earnings, without either a concomitant decline in liability growth or an offsetting increase in the amount of capital raised in financial markets. The year-end low for the aggregate thrift capital ratio was reached in 1982 (following two years of large operating losses), when the regulatory ratio was 3.83 percent and the GAAP ratio was 3.07.

Accompanying the decline in the aggregate industry capital ratio, especially in the early 1980s, was a sharp rise in the percentage of the industry with low capital ratios. During the late 1970s, for example, less than one-half of one percent of all FSLIC-insured institutions had negative capital and only about 5 percent had capital/liability ratios of less than 3 percent. By the end of 1982, however, 2 percent of all FSLIC-insured institutions had negative regulatory capital, 24 percent had regulatory capital/liability ratios of 0-3 percent,

44 percent had ratios of 3-6 percent, and 29 percent had ratios over 6 percent. As measured by GAAP capital, 7 percent of the industry had negative capital at the end of 1982, 27 percent had capital/liability ratios of 0-3 percent, 39 percent had ratios of 3-6 percent, and 28 percent had ratios in excess of 6 percent. Since then, despite the rise in the aggregate industry capital ratio, the proportion of FSLIC-insured thrifts with negative capital has increased to 8 percent by the regulatory measure and to 16 percent by the GAAP measure.

The Bank Board considers the current level of industry capital inadequate in terms of the risk to which the FSLIC is exposed, by historical standards, and in terms of the 6 percent requirement for banks established by the Federal bank regulatory agencies. It was for this reason that the Bank Board amended its regulation establishing minimum capital requirements last August to increase this capital requirement to 6 percent of liabilities over a period based in part on the level of industry profitability, with provision for an even higher requirement for institutions with especially risky assets and lower requirements for institutions that follow management policies that result in low interest rate risk.

The preceding discussion of thrift industry capital has not taken into account a recent regulatory change which allows thrifts, like commercial banks, to consider general loss reserves as capital. Preliminary information for March 1987, however, suggests this change has increased the industry regulatory capital by about 6 percent.

Question 2

How sensitive is asset quality to regional and national economic conditions? What is the current level of asset quality, and how has it been affected in recent decades by successive periods of recession and recovery? What are present conditions in real estate lending, and how do they compare with those of recent years?

Answer 2

Historically, the quality of the assets held by thrifts has been only moderately sensitive to changes in general economic conditions. This is indicated by the behavior of the ratio of scheduled items to total assets. Scheduled items is a measure of substandard assets adopted by the Bank Board as a supervisory/regulatory tool in the mid-1960s, when there was concern regarding asset quality. The apparent peak for this ratio in the early period was December 1964, when it reached 2.6 percent. The scheduled items ratio then dropped steadily for seven years (without being affected by one general business cycle) reaching a low of 0.7 percent in June 1973. It then rose again reaching a cyclical peak of 1.3 percent in December 1975,

well after the trough of the 1974-75 general business cycle. The scheduled items ratio then declined to a low of 0.7 percent in December 1979. Since then it has risen steadily, and was at a high of 3.4 percent at year-end 1986, although regulatory changes have resulted in some upward bias in recent ratios as compared to earlier years.

The scheduled items ratio has always varied substantially from area to area, reflecting regional differences in both economic conditions and management practices (or malpractices). At the end of 1964, for example, when the national ratio was 2.6 percent, state ratios ranged from 18.4 percent in Nevada and 5.8 percent in Arizona to less than 1.0 percent in Rhode Island, New York, New Jersey and Virginia. Similar wide regional variation exists currently, although the effects of differing economic conditions have been muted by the increase in interstate lending in recent years. Nevertheless, at the end of 1986, when the national ratio was 3.4 percent, state ratios ranged from 12.5 percent in both Texas and Oklahoma, 9.7 percent in Alaska, 9.6 percent in Wyoming and 8.0 percent in Louisiana to less than 1 percent in most of New England and in Delaware and Michigan.

States affected by the energy industry depression all had high scheduled item ratios at year-end, but this was not the case for all agricultural areas. Indeed, the fact that asset quality is affected by both regional economics and management practices is clearly evident from Texas data, which indicate that loan delinquencies ratios began to rise in late 1983, well before the sharp drop in oil prices in late 1985. Indeed, about one-half of the increase in the delinquency ratio between 1983 and the end of last year occurred prior to the big oil price drop. The importance of management practices to the quality of assets, of course, has been illustrated by the substantial number of case histories I have cited in earlier testimony.

Current real estate market conditions vary substantially, both by region and by type of property. Residential markets are generally much stronger than commercial building, with an excess of office space in a number of major metropolitan areas. Housing markets have been generally strong and are expected to continue that way in most parts of the country, with the principal exception of energy producing areas.

Question 3

What are the current levels of savings and loan earnings with respect both to equity and to total assets, and how do these levels compare with those of years past?

Answer 3

FSLIC-insured institutions had an aggregate return on assets of 0.39 percent last year. This was down from the 0.39 percent return on assets of these firms in 1985 and the poorest since the negative returns in 1981 and 1982 (-0.73 percent and -0.65

percent, respectively). During the decade of the 1970s, the return on assets of thrifts averaged 0.67 percent and ranged from a low of 0.47 percent in 1975 to a high of 0.82 percent in 1978.

This customary measure of industry profitability, however, has been distorted in recent years by the fragmentation of thrifts into a profitable majority, comprising approximately 82 percent of all FSLIC-insured institutions, and an unprofitable minority, with the losses of the latter group offsetting much of the substantial net income of the profitable institutions. Indeed, last year the return on assets of the profitable institutions alone was a near-record 1.02 percent, up from 0.88 percent in 1985 and the highest return on assets since the 1950s, when thrifts were taxed at sharply lower rates.

In sharp contrast, the return on assets of the unprofitable one-fifth of the industry last year was -3.80 percent. This, of course, was largely a reflection of earlier poor loan underwriting, high risk investment, and excessively rapid growth by many of these institutions, often coupled with regulatory violations and, sometimes, fraud. The resulting problems were exacerbated in some areas by the subsequent depression in the energy and agricultural sectors of the economy and in general by the reduced resources of the FSLIC fund, which made it impossible to resolve problem cases as promptly as in earlier years.

Aggregate thrift profitability as measured by the return on average equity has exhibited the same general pattern described above for the return on assets measure. The average return on GAAP equity of FSLIC-insured firms was 2.44 percent last year, only one-fifth the 12.07 percent return in 1985 and the poorest since the loss years of 1981-82. During the 1970s, the return on equity of FSLIC-insured institutions averaged 11.16 percent, ranging from 7.84 percent in 1975 to 14.91 percent in 1978.

Question 4

How do current liquidity levels, particularly in the form of uninsured and short-term borrowed funds, compare with those of previous years? What has been the impact of the increased use of brokered deposits?

Gross holdings of liquid assets by FSLIC-insured institutions have been relatively large in recent years and generally more than twice the level required by Bank Board regulation. At the end of 1986, assets eligible to satisfy the Board's liquidity requirement held by all FSLIC-insured institutions totaled $119 billion and comprised 10.2 percent of all thrift assets. This ratio has generally been 10 percent or greater since late 1982. Prior to that time, when liability holdings were perceived to be generally less volatile, the ratio had been considerably lower; in 1980 and 1981, for example, it was around 7 1/2 percent.

At year-end 1986, funds on deposits at thrifts that were not covered by FSLIC insurance (i.e., amounts in excess of $100,000) are estimated to have totaled $67.0 billion; this represented 56 percent of liquid assets holdings and 7 1/2 percent of total deposits. Both of these ratios have been relatively stable since 1983; earlier, they were somewhat lower.

The proportion of deposits at thrifts that were originated by brokers has also been relatively stable for the last several years, after rising sharply in the early 1980s (from less than one-half of one percent of total deposits at the end of 1979 to 5.0 percent in March 1984) following the lifting of regulatory restrictions. This ratio was 5.0 at the end of last year. Recent changes in the Board's capital and other regulations, and improved supervision, have been generally successful in preventing the type of unsustainable rapid growth with brokered funds that had caused supervisory problems earlier.

Question 5

What is the present number of so-called "problem institutions"? What is the amount of total deposits held by these institutions? What supervisory actions are being taken in response to the trend in the number of "problem institutions"?

Answer 5

As of April 30, there were 387 institutions in the significant supervisory caseload, with total assets of approximately $138 billion.

Since July 1985, the Federal Home Loan Bank Board has transferred its examination staff to the Federal Home Loan Banks, increased its examination staff by over 100%, and directed the expansion of the supervisory staff at each of the Federal Home Loan Banks. This restructuring has allowed the Board to better address the job of examining and supervising the industry, especially in terms of the human resources dedicated to this task. Other actions taken during this period have included Chairman's directives to the Principal Supervisory Agents in the 12 Federal Home Loan Bank districts to take strong and forceful supervisory and enforcement action against institutions operating in violation of statutes, regulations or written agreements entered into with the Bank Board, or individuals engaging in activities which undermine the safe and sound operation of an insured institution. Such action may include, the use of cease and desist orders, supervisory agreements, and removal and prohibition orders. In an effort to maximize effectiveness we have expanded and continue to expand our human resources dedicated to supervision, and we continue to maximize our limited enforcement authority under law. We have

also taken effective preventive regulatory steps that have reduced losses and allowed the Bank Board to make more timely supervisory responses. These regulatory initiatives include the net worth/growth rule, capital rule, direct investment rule, classification of assets rule, proposed low equity loan rule, and the new accounting rule.

Question 6

How many institutions have had to be liquidated, merged, or assisted to avert failure so far this year? How does this number compare with those in previous years? Do you expect this trend to continue?

Answer 6

Through May 8 of this year, there have been a total of 24 mergers/acquisitions or institution closings through liquidations with total assets of $5.6 billion. Transactions for 1987 are broken down according to the following categories: FSLIC assisted mergers/acquisitions (10 - $3.9 billion); liquidations (12 - $1.7 billion); and supervisory mergers (2 -$82.4 million).

The pace of merger/acquisition and liquidation activity for the first five months of this year remains comparable to last year for the same period when measured in terms of the volume of assets of completed transactions and closings (table). The 1987 pace is anticipated to slow substantially throughout the remainder of the year because of the limited resources of the insurance corporation which make further permanent resolutions unlikely until FSLIC recapitalization. In the interim, due to inadequate funding, it is anticipated that a significant number of Bank Board actions will be taken to place additional institutions into the management consignment program to slow down the rate of future losses facing the FSLIC.

The level of problem institution closings through mergers/acquisitions, with FSLIC assistance as well as those directed by the Federal Home Loan Banks without the use of the insurance corporation's funds, and liquidations are presented in the enclosed table. As indicated, the peak year of merger activity was 1982 when high interest rates collapsed thrift institution earnings and produced a large number of assisted and unassisted supervisory mergers. Since that time, the merger and liquidation activity has increased steadily as interest rate spread problems of the earlier years have been translated into asset quality problems in the current crop of thrift cases, which are much more expensive and difficult to resolve.

The extent of merger activity involving problem institutions as well as non-supervisory mergers is expected to remain at moderate to high levels for an indefinite period. Factors driving the pace of the combinations include: (1) about 20 percent of the industry lost money during 1986; (2) higher

average capital requirements for thrift institutions over the next 6 years; (3) the current large number of insolvent institutions that remain in operation; and (4) the increasing level of competition in the mortgage financing business. All of these factors will continue to stimulate the volume of FSLIC-assisted and supervisory mergers, liquidations, as well as non-supervisory or straight mergers. The increasing number of anticipated combinations will likely produce a more concentrated financial structure for the thrift industry in the years ahead.

THRIFT INSTITUTIONS MERGED OR LIQUIDATED TO AVERT FAILURE[1]/

	NUMBER	TOTAL ASSETS ($ Millions)
1987	24	5,640 [2]/
1986	55	14,379
1985	45	9,737
1984	36	5,949
1983	73	7,268
1982	255	37,367
1981	82	15,121
1980	32	2,821

Question 7

How many bank examiners does your agency employ? How does this number compare with those of previous years? Do you feel the examiner workforce under your purview is adequate?

In addition to the above information, please provide any other testimony you feel would augment the Committee's understanding of the current financial condition of the institutions under your agency's jurisdiction.

1/ The tally includes: (a) supervisory mergers arranged by the Federal Home Loan Banks; (b) FSLIC-assisted mergers; and (c) thrift institutions liquidated by the FSLIC.

2/ Data in this category are as of May 8, 1987.

Answer 7

As of December 31, 1986, the Federal Home Loan Bank System employed 1,524 professional examination personnel. This number was the culmination of an increase in the examination staff following the transfer of the examination functions from the Federal Home Loan Bank Board to supervision in the 12 Federal Home Loan Bank districts on July 8, 1985. The professional examinations staff numbered 747 as of July 8, 1985, and 1,081 as of December 31, 1985. Until July 1985 the staff levels were essentially unchanged for several years, despite a dramatic increase in the magnitude and complexity of assets. OMB and OPM intransigence left the Bank Board with a grossly inadequate examination force prior to the transfer.

We believe that the examiner workforce under our purview is far more adequate than before. We are also quite pleased with the quality of the staff hired during this period of expansion. As would be expected, this influx of new personnel has brought the need for substantial training to bring their knowledge base up to an acceptable level. To meet this need, in 1985 we established a separate Bank System Office of Education which has been furnishing such training on an accelerated basis.

During the last three years, the professional supervisory staff in the Federal Home Loan Bank districts has nearly tripled.

EXHIBIT 1

United States
General Accounting Office
Washington, D.C. 20548

Comptroller General
of the United States
MAY 1 4 1987

B-114893

To the Chairman
Federal Home Loan Bank Board

We have examined the consolidated statements of financial condition of the Federal Savings and Loan Insurance Corporation as of December 31, 1986 and 1985, the related consolidated statements of income and expense and reserves, and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted government auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. In addition to this report on our examination of the Corporation's 1986 and 1985 financial statements, separate reports are being issued to you on our study and evaluation of internal accounting controls and of compliance with laws and regulations.

The accompanying financial statements reflect a net loss of almost $11 billion for 1986 and a deficit of more than $6 billion at the end of 1986. Troubled sectors of the savings and loan industry have placed a severe strain on the Corporation. The average size of savings and loan institutions that have failed and the number of institutions receiving financial assistance or special supervisory attention from the Corporation have steadily increased during the last several years. From December 31, 1985, to December 31, 1986, the Corporation's caseload of institutions in serious financial trouble virtually doubled--from 93 to 183.

The Corporation's 1986 net loss was primarily due to the provision for losses of almost $9 billion for troubled institutions in the Corporation's current caseload that will require new or increased financial assistance. The provision increased to $9 billion in 1986, from $1.6 billion in 1985, because of the increasing number of troubled institutions needing regulatory action. These institutions all have large deficits and continue to incur substantial operating losses, which will increase the Corporation's costs to resolve industry problems.

The 1986 loss provision is not a projection of the cost of resolving all future problems in the industry. The Corporation estimates that more than 180 institutions, including the 183 institutions in its current caseload, will ultimately require assistance. The Corporation believes the cost of providing assistance to about 180 currently insolvent institutions may range up to $21 billion. Assistance to another 130 institutions that currently appear to have little chance of recovery could add another $4 billion to the Corporation's losses. Future losses cannot be precisely estimated because of various uncertainties, such as the quality of each troubled institution's assets, future levels of interest rates, and the economic outlook for sectors of the economy in which a large portion of the troubled institutions operate.

Currently, the Congress is considering legislation to recapitalize the insurance fund. The amounts of capital to be infused under the legislative proposals range from $5 billion to $7.5 billion over 2 years. Given the severity of the situation, it appears that the amounts under consideration would not provide the monetary resources necessary for the Corporation to address the problems in this troubled industry. The previous Congress considered similar legislation but did not enact it into law.

Since the end of 1986, the Corporation's condition has continued to deteriorate. Its cash and investment securities, which declined from $6.1 billion to $4.0 billion during 1986, have further declined, and at May 1, 1987, stood at $913 million. This decrease was caused in part by the Corporation honoring its guarantee of $947.4 million in Dallas Federal Home Loan Bank's advances to insured institutions. As described in note 2, as of December 31, 1986, the Corporation had guaranteed Federal Home Loan Bank advances outstanding of $1.6 billion, including the $947.4 million subsequently paid to the Dallas Bank. Because of the Corporation's impaired liquidity, should other Federal Home Loan Banks request the Corporation to honor their guaranteed advances, the Corporation may be unable to do so.

These factors indicate that the Corporation may be unable to continue to fulfill its mission and meet its financial obligations. The 1986 consolidated financial statements presented herein do not reflect any adjustments that might

be necessary should the Corporation be unable to continue in its present form.

As a result of its losses, the Corporation has exercised its authority under sections 404 (e) and (h) of the National Housing Act, as amended (12 U.S.C. 1727 (e), (h)), to use its secondary reserve to help absorb operating losses. Accordingly, the secondary reserve declined from $774 million at December 31, 1985, to zero at December 31, 1986. The remainder of the losses were charged to the primary reserve. The secondary reserve comprised the equity of certain savings and loan institutions in the Corporation based on premium prepayments and related interest not yet paid to those institutions.

In our opinion, subject to the Corporation obtaining sufficient funds to continue operating and to meet its obligations, the financial statements referred to above present fairly the financial position of the Federal Savings and Loan Insurance Corporation as of December 31, 1986 and 1985, and the results of its operations and the changes in its financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Charles A. Bowsher
Comptroller General
of the United States

May 1, 1987

EXHIBIT 2

[illegible]

1986

[illegible]

Exit Fees

Return on Assets	Return on Equity	2+2	3+1	4+4	5+0	0+5
.083	16.600	.625	.6253	.6000	1.04166	1.251
		(49% OF INC.)	(75% OF INC.)	(100% OF INC.)	(125% OF INC.)	(150% OF INC.
Profits for $50 million firm						
$420,000		$210,000	$312,500	$410,000	$520,800	$625,000
Profits for $100 million firm						
$850,000		$425,000	$625,000	$800,000	$1,041,600	$1,250,000
Profits for $1 billion firm						
$8,500,000		$4,250,000	$6,250,000	$8,200,000	$10,416,000	$12,500,000

[illegible]

Exit Fees

Return on Assets	Return on Equity	2+2	3+1	4+4	5+0	0+5
1.324	16.100	.625	.6250	.6000	1.04160	1.251
		(333 OF INC.)	(466 OF INC.)	(640 OF INC.)	(800 OF INC.)	(960 OF INC.
Profits for $50 million firm						
$420,000		$210,000	$312,500	$410,500	$520,800	$625,000
Profits for $100 million firm						
$1,320,000		$625,000	$625,000	$800,000	$1,041,600	$1,250,000
Profits for $1 billion firm						
$13,200,000		$6,250,000	$6,250,000	$8,200,000	$10,416,000	$12,500,000

Prepared by the Office of Policy and Economic Research
Federal Home Loan Bank Board
March 31, 1987

The CHAIRMAN. Thank you very much, Mr. Gray.
Ms. Burkhart.

STATEMENT OF ELIZABETH F. BURKHART, MEMBER, NATIONAL CREDIT UNION ADMINISTRATION BOARD

Ms. BURKHART. Thank you, Mr. Chairman.

NCUA is pleased to testify at these hearings on the condition of federally insured financial institutions.

On behalf of the agency's Chairman, Senator Roger W. Jepsen, I extend his regrets that, due to a longstanding commitment, he is unable to be here today.

The Chairman also asked me to convey his personal gratitude, to which I add my own, for your work in securing rapid passage of S. 790. This important legislation contains, in title V, a number of credit union amendments, including a measure to restore and make permanent NCUA's vital conservatorship authority.

I recognize, Mr. Chairman, that your aim in this Congress is a comprehensive and far reaching examination of today's financial marketplace. While numerous modifications of other parts of the financial system are under consideration, credit unions are requesting no further significant legislative changes.

CREDIT UNIONS ARE SOUND

You have asked our agency to comment on the current condition of credit unions and I am pleased to report that, overall, credit unions are basically sound. In 1986, Federal credit union shares grew at a near record rate of about 23 percent, to $88 billion. However, loans grew by only 15 percent to $55 billion. So the loan-to-share ratio slipped to 63 percent.

The disparity between share and loan growth has resulted in significant excess liquidity in the credit union system. This is a matter of some concern to us. For 1986, 1,360 Federal credit unions, or 14 percent, reported losses totaling $44 million. This also is an area of concern for us.

The number of federally insured "problem" credit unions—that is, those having early warning system codes of 4 and 5—totaled 799 at year end 1986. These credit unions, however, represent only 5 percent of the insured shares in the credit union community.

At year-end, December 1986, there were only 24 credit unions receiving special assistance from the National Credit Union Share Insurance Fund. That's the lowest level since 1978. This represents cash assistance of $19 million and noncash assistance or guarantee accounts of $36 million. This total assistance to these 24 credit unions represents less than 4 percent of the assets of the Share Insurance Fund and the shares of these credit unions represent only 1 percent of total insured shares.

The Insurance Fund's financial costs have dropped dramatically since 1982 when the fund incurred costs of $78 million. That's the highest since their inception. Financial costs in 1986 were only $38 million and these were due primarily to cases involving insider abuse and substandard member business loans.

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The assisted mergers have dropped from 203 requiring $27 million in assistance in 1983 to 58 requiring only $4 million in assistance in 1986.

Involuntary liquidations have dropped from 251 in 1981 to only 36 in 1986.

The statistics for the first quarter of this calendar year indicate continued strong growth in member savings. Problem credit unions have declined by 2, to 797, while credit unions requiring assistance have remained constant.

The insurance fund's investments have generated sufficient income to cover all expenses and to provide a surplus net income to maintain the fund's equity ratio close to our goal of 1.3 percent. Because we have kept the equity ratio at 1.3 percent, insurance premium assessments have been waived for the past 3 fiscal years.

For the third straight year, the share insurance fund has received an unqualified audit opinion from an independent accounting firm and the latest GAO audit review showed no significant deficiencies.

The NCUA Board continues to be firmly committed to full and fair disclosure of its financial performance and operating results.

As I said earlier, the condition of credit unions remains good. However, I would not wish to leave the committee with the impression that there are no problems or concerns. Excess liquidity and the consequent search for higher-yielding investment options are among our major concerns. We have alerted credit unions about the potential risk of seeking high-yield investments and continue to caution them that the best possible investment is a loan to a member.

At NCUA, we are attempting to anticipate and stay ahead of problems. When it became apparent that cases of substandard business lending and insider abuse, although few in number, were a major cause of credit union losses for the share insurance fund, we embarked upon a review to determine just what lending patterns led to these losses. Our findings resulted in the Business Loan Rule which the NCUA Board adopted last month.

I believe that the agency has acted aggressively and responsibly in these problem areas. NCUA's actions will help preserve the well-deserved reputation for honesty and integrity of credit union officials, volunteers, and employees. We continue our dialog with credit union officials, stressing their fiduciary responsibilities.

We have been moving deliberately to improve supervision of credit unions by adding examiners and by training and equipping them better because for NCUA deregulation means more, not less, supervision.

We have embarked on an ambitious training program involving in-house as well as academic resources. In fact, we have tripled our training budget over the last 2 years.

The NCUA Board has approved the purchase of lap-top computers for our examiners. These state-of-the-art tools will enable our examiners to do a high quality job in less time and to better analyze trends for early detection of emerging problems. This will enable the agency to alert credit unions to trends we consider harmful to their health.

In summary, Mr. Chairman, credit unions are prospering in today's deregulated and terribly competitive environment. They are doing so by sticking to the basics which historically have served them well. That is, by providing convenient personal financial services at a reasonable and a fair price.

Thank you, Mr. Chairman, and I, too, welcome any questions.

[The complete prepared statement of Elizabeth J. Burkhart follows:]

TESTIMONY OF

ELIZABETH F. BURKHART

Mr. Chairman and Members of the Committee. The National Credit Union Administration is pleased to testify at these hearings on the condition of federally-insured financial institutions.

On behalf of the Agency's Chairman, Senator Roger W. Jepsen, I extend his regrets that, due to a long standing commitment, he is unable to be here today.

The Chairman also asked me to convey his personal gratitude, to which I would add my own, for your work in securing rapid passage of S. 790. This important legislation contains, in Title V, a number of credit union amendments including a measure to restore and make permanent NCUA's vital conservatorship authority.

We hope the restoration of conservatorship and the other supervisory changes in Title V will soon become part of a final legislative product on its way to the White House.

I recognize that your aim in this Congress, Mr. Chairman, is a comprehensive and far reaching examination of today's financial marketplace. Credit unions are and will continue to be vital components of this marketplace.

While numerous modifications of other parts of the financial system are under consideration, credit union operations remain basically sound. I would note that credit unions are requesting no further significant legislative changes.

Mr. Chairman, you asked our Agency to comment on the current condition of credit unions. I am pleased to report that, overall, credit unions are strong. In 1986, the total number of credit union members grew to over 51 million with combined savings of over $156 billion. We also witnessed strong growth trends in loans, investments and capital.

NCUA granted 44 new Federal charters in 1986, adding a potential 11.7 million new members. In addition, another five million persons became eligible to join existing credit unions as a result of field of membership expansions.

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In 1986, Federal credit union shares rose at a near record rate of 22.8 percent to $87.9 billion. Because loans grew by only 14.6 percent to $55.3 billion, the loan to share ratio slipped to 63 percent.

This disparity between share and loan growth has resulted in an accumulation of significant excess liquidity. As a result, total investments increased last year by 36 percent. Reserves (capital) grew 18 percent to $5.8 billion while total assets grew 22.1 percent in the same period.

For 1986, 1,360 Federal credit unions or 14 percent reported losses totaling $43.8 million. In 1985, the number of Federal credit unions reporting losses was 1,178 or 12 percent and losses totaled $31.6 million. For all Federal credit unions, net income increased by 20.1 percent to $626.2 million last year.

The number of federally-insured "problem" credit unions (those given Early Warning System Codes 4 and 5) rose somewhat, from 722 at year end 1985 to 799 at year end 1986.

Problem credit unions represented less than 6 percent of all credit unions in 1986 and only 5.3 percent of insured shares or $7.2 billion. There were 24 credit unions receiving special assistance from the National Credit Union Share Insurance Fund, the lowest level since 1978. Generally, these are considered our "worst case" credit unions. By contrast, three times as many--72 credit unions-- were in that category in 1984 and 45 in 1985.

Cash assistance of $18.7 million and non-cash assistance (guaranty accounts) of $35.7 million were outstanding to these 24 credit unions at year end. This is less than 4 percent of the assets of the National Credit Union Share Insurance Fund.

Statistics for the first quarter of this calendar year indicate continued strong growth in member savings. Shares in Federal credit unions have increased $6.8 billion at an annualized rate of 31 percent to a total of $94.7 billion. At the same time, problem credit unions declined slightly to 797 credit unions with $6.7 billion in insured shares. This represents 5.5 percent of credit unions and 4.6 percent of insured shares.

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The number of credit unions requiring the assistance of the National Credit Union Share Insurance Fund has remained relatively constant throughout this quarter.

In July 1984, President Reagan signed legislation to capitalize the National Credit Union Share Insurance Fund. The capitalization plan quadrupled the fund's equity and today it is the best reserved of all the Federal deposit insurance funds. As of April 30, 1987, every $100 of savings at federally-insured credit unions is backed by $1.27 in insurance.

We at NCUA are extremely proud of the manner in which credit unions rallied in support of the capitalization legislation. It was a successful cooperative effort to strengthen the credit union system.

The Fund's insurance losses have dropped dramatically over the past five years. In 1982, the Fund incurred its highest loss since its inception, $78 million. In contrast, the Fund lost $38 million in 1986, due primarily to losses involving insider abuse and member business loans. These credit unions have since been liquidated or merged.

Last year, the Fund had guarantee contract commitments of about $5 million compared to $172 million in 1982, a decrease in contingent liabilities of 97 percent.

In 1985, 1986 and this fiscal year, the Fund paid and will be able to pay all of its administrative and insurance costs without insurance assessments. Investments in U.S. Treasury securities have generated sufficient income enabling the Fund's equity ratio to be maintained at close to the goal of 1.3 percent.

By waiving insurance premium assessments over the past three fiscal years, the Agency has saved credit unions $265 million in fees. Since their deposit is an earning asset whose dividend is determined by the Fund's performance, insured credit unions have a direct financial stake in its operation.

In 1986, for the third straight year, the Share Insurance Fund received an unqualified audit opinion from an independent accounting firm. The NCUA Board is firmly committed to continued full and fair disclosure of its financial performance and operating results.

The sound financial condition of credit unions has made this positive performance possible. In 1981, there were 251 involuntary liquidations. Last year only 36 involuntary liquidations occurred, a reduction of 86 percent. In 1983, 203 mergers took place requiring $26.6 million in assistance from the Fund. Last year, 58 assisted mergers cost only $3.6 million.

As I said earlier, the condition of credit unions remains good. However, I would not want to leave the Committee with the impression that there are no problems or concerns. Excess liquidity and the consequent search for investment options are among our major concerns. We have alerted credit unions about the potential pitfalls of some investments and continue to caution them that the best possible investment is a loan to a member.

At NCUA, we are attempting to anticipate and stay ahead of problems. For example, by early last year it became apparent that cases of questionable business lending and insider dealing, although few in number, were a major cause of credit union losses for the Share Insurance Fund.

Although less than 1 percent of credit union assets were devoted to business loans in 1985, 30 percent of those were problem loans compared to 2 percent for all other loans to members. Review of problem cases showed inadequate loan policies, underwriting standards, documentation and collateral, and poor monitoring and collection procedures. There was also a lack of portfolio diversification.

Last month, the NCUA Board adopted a business lending rule requiring written loan policies and diversification and prohibiting preferential treatment for officials and senior employees. The rule takes effect July 1 for all federally-insured credit unions.

Cases of insider abuse, also few in number, have inflicted severe costs on the credit union system. The worst example is HYFIN Credit Union in New York where we estimate our gross losses eventually will be nearly $50 million.

Early in 1986, after reviewing our conflict of interest regulations and provisions in the U. S. Criminal Code, we determined no new laws or regulations were needed. Instead, we are emphasizing improved education and enforcement.

I believe the Agency has acted aggressively and responsibly in these problem areas. NCUA's actions will help preserve the well deserved reputation for honesty and integrity of credit union officials, volunteers and employees.

We have communicated with credit union officials about their fiduciary responsibilities; we are developing a handbook on the subject, and we have increased our litigation staff. We have worked with other financial agencies and the U. S. Department of Justice to develop a new criminal referral and tracking system and will issue guidelines under the Bank Bribery Act.

In addition, NCUA has been moving deliberately over the past year to improve supervision of credit unions by adding examiners and by training and equipping them better. Being an examiner is a very tough job. Our examiners are part auditor, part teacher. Unless they have the training and the time to do a good job, they cannot provide support when it is needed. Deregulation for NCUA means more, not less, supervision.

We were extremely pleased last year when the Office of Management and Budget gave us permission to hire 205 additional examiners over two years. In our best judgment, this is the number needed to perform thorough and meaningful exams of credit unions nationwide.

Both new and senior examiners need training to do the job right. We have embarked on an ambitious training program, involving in house as well as academic resources. This includes training in commercial lending at the prestigious Louisiana School of Banking. We have tripled our training budget over the last two years and will continue to expand our training efforts until first rate training becomes a matter of course.

Recognizing another element of the future, the NCUA Board approved the purchase of lap-top computers for our examiners. These state of the art tools will enable our examiners to do a high quality job in less time and to better analyze trends for early detection of emerging problems. This will enable the Agency to alert credit unions to trends we consider harmful to their health.

The Board also has directed the implementation of automated credit union examination procedures. Collectively, these technological improvements will provide increased productivity and greater depth and scope of analysis.

In a related area, we have established a close and cooperative working arrangement with the National Association of State Credit Union Supervisors (NASCUS). With NASCUS, we have developed a model examination report covering all major areas of operation in both Federal and state-chartered credit unions. It will give us a uniform approach to the evaluation of safety and soundness. We believe the model exam will improve risk monitoring, data evaluation and examiner performance at both the state and Federal level.

In summary, Mr. Chairman, credit unions are prospering in today's deregulated and competitive environment. They are doing so by sticking to the basics which have historically served them well. That is, by providing convenient personal financial services at a reasonable and fair price.

Credit unions are and have been ready and willing to serve the great mass of low and moderate income citizens, a significant part of the market often overlooked or abandoned. As member run institutions, credit unions by and large are providing the kind of personal consumer oriented services preferred by millions of Americans.

Thank you, Mr. Chairman.

ADDENDUM

ANSWERS TO SPECIFIC QUESTIONS IN
CHAIRMAN PROXMIRE'S LETTER OF MAY 6, 1987

May 21, 1987

1. Are current levels of capital, including consideration of classified assets adequate? How do current capital levels compare with levels in previous years?

Current levels of capital are considered adequate. Total capital (reserves and undivided earnings) was $9.2 billion at year end 1986, $7.7 billion at year end 1985 and $6.2 billion at year end 1984. As a percentage of total assets, primary capital declined from 7.07 percent in 1984 to 6.65 percent in 1986. As of December 31, 1986, total capital was 489 percent greater than all delinquent loans. The comparable figures for year end 1984 and year end 1985 were 480 percent and 491 percent, respectively.

2. How sensitive is asset quality to regional or national economic conditions? What is the current level of asset quality, and how has it been affected in recent decades by successive periods of recession and recovery and in recent years by the growth in credit union deposits?

In general, the level of asset quality tends to rise during periods of economic expansion and decline during periods of economic contraction. As measured by the ratio of problem assets to total assets, which was .32 percent as of year end 1986, problem assets were at their lowest level in eight years.

3. What are the current levels of credit union earnings, and how do these levels compare with those of years past?

Net income was $914.1 million at year end 1986, $776.7 million at year end 1985 and $690.4 million at year end 1984. For 1986, a total of 2,135 or 14.5 percent of credit unions reported losses totaling $108.6 million. In 1985, the number of credit unions reporting losses was 2,062 or 13.7 percent and losses totaled $75.9 million.

4. How do current liquidity levels, particularly in the form of uninsured and short term borrowed funds, compare with those of previous years? What has been the impact of the increased use of brokered deposits?

In 1986, total shares grew 24 percent, while total loans grew only 16 percent. The disparity between share and loan growth has led to a high level of liquidity among credit unions. As a result, credit union investments (the other major alternative for cash inflow) expanded 38 percent, while all borrowings declined 14 percent. Borrowed funds represented only about .4 percent of assets in credit unions as of December 31, 1986. Brokered deposits are not considered a problem in credit unions. Less than .1 percent of assets were received through brokered deposits in 1986.

5. What is the present number of so-called "problem institutions?" What is the amount of total share accounts held by these institutions? What supervisory actions are being taken in response to the trend in the number of "problem institutions"?

The number of problem credit unions (Early Warning System Codes 4 and 5) rose from 722 at year end 1985 to 799 at year end 1986. Total shares in these credit unions ($7.2 billion) represented only 5.3 percent of all insured shares. The worst problem credit unions are represented by those credit unions receiving special assistance from the National Credit Union Share Insurance Fund. At year end 1986, there were 24 credit unions receiving special assistance from the National Credit Union Share Insurance Fund, the lowest level since 1978.

6. How many institutions have had to be liquidated, merged, or assisted to avert failure so far this year? How does this number compare with those in previous years? Do you expect this trend to continue?

There were 58 assisted mergers in 1986, representing $3.6 million in losses to the National Credit Union Share Insurance Fund. There were 63 assisted mergers in 1985 and 92 such mergers in 1984. In 1986, there were 36 involuntary liquidations which cost approximately $22.4 million. In 1985, 31 credit unions were liquidated at a cost of $6.0 million. For 1987, the number of assisted mergers and liquidations are expected to remain at or about the 1986 level.

7. How many examiners does your agency employ? How does this number compare with those of previous years? Do you feel the examiner workforce under your purview is adequate?

The Agency employed 442 examiners as of March 31, 1987. There were 407 examiners on staff at year end 1986 and 358 at year end 1985. The Agency plans to hire 59 more examiners during the current fiscal year bringing the total to 507. The planned total of 507 is sufficient to carry out the Agency's supervision program for the present fiscal year.

The CHAIRMAN. Thank you very much, Ms. Burkhart.

Mr. Gray, the House of Representatives has included extensive forbearance language in its FSLIC recapitalization bill.

INTENT OF FORBEARANCE LANGUAGE

In as precise terms as you can, if you can tell us, what is the intent of that language and what impact would it have on the Federal Home Loan Bank examination and supervision of thrift institutions?

Mr. GRAY. Mr. Chairman, in my opinion, the intent of the language is to protect insolvent savings and loan operators from being taken over and to keep the Bank Board from resolving those cases. That, in my opinion, is the primary purpose of that legislation.

The CHAIRMAN. To keep the Home Loan Bank Board from resolving those situations?

Mr. GRAY. Right.

The CHAIRMAN. Well, can you give us some notion of what effect in numbers that is going to have on your ability to meet that problem?

Mr. GRAY. It will make it impossible for the recapitalization to serve any meaningful purpose.

The CHAIRMAN. That means it would cost a great deal more?

Mr. GRAY. Yes, If we cannot resolve these hopelessly insolvent cases and the problem loans continue to remain on the books of these institutions without our being able to deal with them, the operating losses of these institutions will continue to mount.

Last fall when I was talking about the rate of net operating losses at these kinds of institutions, we were talking about net operating losses of between $2 and $3 billion a year. These losses have accelerated to almost $4 billion a year and the longer those institutions are not dealt with, the greater will be the eventual bill which somebody is going to have to pay, either the taxpayers or those who fund the recapitalization.

The CHAIRMAN. Well, that's obvious, but what I'm trying to get at, Mr. Gray—is there any way that we can have forbearance language, modify the language, change the language, so that it would help in some cases but that it would not tie your hands?

Mr. GRAY. We already have a formal forbearance policy. The statement of this policy has appeared in the Federal Register, and we have been following the practices for a considerable time. The forbearance we have been exercising, particularly compared to that of the commercial banking regulators, is extraordinarily liberal.

If you place into statute these kinds of rules, you most definitely tie the hands of the regulator. I'm not particularly happy with some of the forbearance language in the Senate bill, but it's at least far less of a disaster than that in the House bill. If you put those things in statute, you will tie the hands of the regulator. My successor is going to have a very difficult time. The agency is going to be spending a lot more time trying to figure out how to deal with that than regulating our institutions.

The CHAIRMAN. Now GAO recently reported that on a generally accepted accounting principle basis, the GAAP basis, FSLIC is insolvent.

What specifically were the GAO findings and what are the implications of those findings?

Mr. GRAY. The findings are that, based on a methodology that was agreed on by the GAO and the Bank Board, there is a total of almost $11 billion in reserves that has been in essence required by our auditor. This places us in an insolvent position, according to GAAP, of about $6.3 billion.

The CHAIRMAN. What's the secondary reserve and what has happened to it and what does the thrift industry want the FSLIC to do about it?

SECONDARY RESERVE

Mr. GRAY. Well, the secondary reserve, according to the GAO in its opinion to us, has been extinguished. That's some $823 million which has counted on the books of these institutions as an asset.

The general counsel of the Bank Board further opined that there was no way to resuscitate the secondary reserve without specific legislation.

Yesterday I sent you and Chairman St Germain a draft of legislation to resuscitate the secondary reserve, but I would point out that it's going to be extremely difficult for the accounting profession to allow these amounts to be counted as assets, even with resuscitation. And I think there are real difficulties in the Congress attempting to mandate what constitutes GAAP, in order to allow the secondary reserve amounts to count as an asset.

But at the very least, we have done what I think is basically appropriate to seek legislative language which the conference committee could pursue to bring the secondary reserve back into existence.

The CHAIRMAN. Mr. Gray, the operations of thrifts have become every bit as complex as banks. I note your agency has rapidly and substantially increased its examination resources in the past few years. As hard as you've worked and as much progress as you have made, do you realize that on a manhour-deposit basis you still have fewer examiners than the Federal Reserve and even than the FDIC—the FDIC has about half what the Federal Reserve has?

Should your successor have further plans to expand your examiner resources?

Mr. GRAY. Yes. My plans have been to expand further the examiner resources. We began when the OMB told us for several years that we were going to get a paltry number of additional examiners. We finally took the matter into our own hands and by using a provision of Garn-St Germain, delegated that responsibility to our principal supervisory agents.

We went from 747 field examiners in mid-1985 to 1,524 at the end of 1986. It is my belief that that general trend should be continued by my successor.

I must say—and I think this was alluded to by my fellow banking regulators earlier—it is difficult, of course, when you are expanding that quickly to be able to do the kind of training, even on-the-job training that is necessary. You pay some price for doing a very rapid expansion. I felt that was a price that we ought to pay.

For every 10 days that an examiner is out in the field, we are providing about 1 day of classroom training. But this increase from 747 to over 1,500 is frankly unheard of and I think that every so often we have to catch our breath in order to make sure that we have examiners who can really do the job the way they ought to. But we ought to continue this.

The CHAIRMAN. I have one more question of you. As you know, Congress is drawing near to passage of a bill that includes FSLIC recapitalization. Chairman St Germain and I have both long held the view that FSLIC recapitalization will be rendered far less effective if Congress does not at the same time close the nonbank bank loophole.

Do you agree with that view? And does closing the nonbank bank loophole really matter?

FSLIC RECAPITALIZATION AND NONBANK BANK LOOPHOLE

Mr. GRAY. Mr. Chairman, I have taken the position for my entire tenure that supports your view of the need to close the nonbank bank loophole. I recall Chairman St Germain also talking about that.

I believe today, as I did when I began, that the nonbank bank loophole ought to be closed. And the reason I say that is because it is very difficult for us to find acquirers to take our failing thrifts if there is an alternative that these potential acquirers can use, namely, the nonbank bank loophole, to get the ability to operate in any number of States. And this franchise value is all we have to sell when we're talking about failing thrifts.

If potential acquirers can file for a nonbank charter in 9 or 10 States; for only $5,000—or whatever it is—that means that those same potential acquirers are simply not going to be interested in taking one of our thrifts.

The CHAIRMAN. Thank you, sir.

Senator Garn.

Senator GARN. Thank you, Mr. Chairman.

On that particular point, it is correct we've all agreed the nonbank bank loophole should be closed for a long, long time. I distinctly remember July 1, 1983 was a nice date to pick. The point being, however, is how you close it and in what form and where?

I would agree with you that the nonbank bank loophole closure would be helpful, but the way it is written in the chairman's bill it specifically provides that those grandfathered nonbank banks, if they buy a failing thrift, lose their nonbank bank status. Therefore, rather than helping as you have just indicated, it does not help. It specifically goes the other direction and will make less acquirers available for the very troubled thrifts that you are trying to find merger partners for.

So are you in favor beyond the general proposition that you want to close the nonbank bank loophole, are you in favor of it as it is closed in S. 790?

Mr. GRAY. Senator, far be it for me to put either of you on the spot.

Senator GARN. I'm trying to put the chairman on the spot.

The CHAIRMAN. I'm hoping you will put Senator Garn on the spot. [Laughter.]

The CHAIRMAN. It's an easy question to answer.

Mr. GRAY. Well, I think I've stated my position. My position is borne of my concern that we would lose the ability to attract acquirers for failing thrifts, because as I say, we have only the franchise value associated with States that we can provide to these potential acquirers.

Now that has been my position. It continues to be my position. I will hope that that can suffice as the answer. In all honesty, I am not that familiar with precisely the way that language is drafted. I've been worrying more about the recapitalization part of the bill than I have this other part. (Letter from Chairman Gray to Senators Proxmire and Garn clarifies this answer.)

Senator GARN. Well, I understand your answer, but I would suggest you might like to get familiar with the language because I understand—I've never misunderstood about how you felt about closing the nonbank bank loophole, nor have you or the chairman ever misunderstood how I felt about closing it. But it's just the opposite of the way I tried to close it last year and going the opposite direction that in order to keep their nonbank bank charter they had to acquire a failing thrift.

So I was trying to do just the opposite by providing that if the nonbank banks wanted to stay in that condition, they'd better help with the failing thrift problem.

The way it has been written in S. 790, it goes the opposite direction. Now the chairman could make that provision considerably more palatable and close the nonbank bank loophole but not specifically say that they will lose their nonbank bank charter if they pick up a failed thrift, because you know darned well they are not going to give up that charter to do that.

Mr. GRAY. And I recognize that we're talking here about the complication of grandfathering and I recognize that there have been a lot of pressure coming from any number of sources on the Congress, on the House, on the Senate, to grandfather any number of these. And I recognize that that introduces a new element.

I guess my point is, I think and it has been my position from the beginning, that so far as the FSLIC is concerned, even grandfathering causes us a problem.

I was arguing from the beginning and I continue to believe today, that we shouldn't have any nonbank banks and we shouldn't even grandfather them if we really are serious about dealing with this problem with respect to FSLIC.

Senator GARN. Well, we tried. There was a bill that passed 89 to 5 that established July 1, 1983 as the cutoff date.

Mr. GRAY. I recognize that.

Senator GARN. And we can dump that problem on the House of Representatives who was not willing to even consider it.

Mr. GRAY. I'm just saying that I think we, from an FSLIC perspective, would be better off period if we didn't have even a grandfathering problem to look at.

Senator GARN. Well, it's just a shame that here my distinguished colleague, the chairman, is right on these issues 95 percent of the time, but when he's wrong, he's wrong.

Ms. Burkhart, credit unions appear to be the real shining star of the financial services industry. Credit union shares grew 22.8 percent to over $87.9 billion last year, a net income increase by 20.1 percent of $626.2 million in 1986. Problem credit unions last year made up less than 6 percent of all credit unions.

Several years ago, credit unions were experiencing some of the same difficulties in 1981 and 1982 that thrifts were. And I'd like you to say why you think this is different. I happen to think it has to do with something we did a couple years ago when we recapitalized your share insurance fund. That has had a lot of fringe benefits besides the obvious of putting the extra billion dollars of capital into that fund.

I'm not trying to put words in—yes, I am—I'm trying to put words in your mouth. Do you think that that had something to do with credit unions' performance now?

Ms. BURKHART. Yes, sir. I think the confidence level in credit unions has increased tremendously. As a matter of fact, the growth is of some concern to us because we thought when we first began to notice it that it was because credit unions were paying too high a dividend. But even after dropping it, the growth continues to be there. I believe that the only thing that's left to explain this is the high confidence level. People have confidence in the credit unions and the National Credit Union Share Insurance.

Senator GARN. Well, it is a rather dramatic turnabout and I'm drawing a parallel. I've been trying to make a point for nearly a year now how vital it was that we proceed with recapitalization of FSLIC. Besides the amount of money that we put back in, I think that it would put that confidence level back into the savings and loan industry as well.

Would you agree with that, Chairman Gray, that beyond the dollars, whether $7.5 billion—and I certainly hope it is not less than the Senate version when we finish this process, but even beyond the amount of money that is needed, that there would be confidence levels and other benefits to come from recapitalization that would help the S&L industry beyond the mere dollars that we make available?

Mr. GRAY. Yes. I would start with the dollars, of course. The fact that the Congress would have acted in a manner that would replenish the resources of the FSLIC is important.

Of course, I have to raise with you my severe concerns, as I have in the past and in my written statement—about the forbearance related to recapitalization and about the issue of exit fees.

There is, of course, no provision for exit fees in the Senate bill. But I must tell you that, in my opinion, if the Congress is going to consider seriously the kind of exit fees that currently exist in the House bill, then it seems to me that the Congress ought to also seriously rethink its whole approach to using the bonding approach to recapitalize the fund. I think it is that serious. And I hope the conference committee will look very carefully at that matter.

Senator GARN. Let me get back to the dollar amount. First of all, you know where we are—$7.5 billion in the Senate and $5 billion in the House. I don't feel that either one are adequate. What level of funding do you think is the minimum necessary? Second, what level do you think the exit fees should be?

MINIMUM FUNDING AND EXIT FEES

Mr. GRAY. Well, with respect to recapitalization, I think that at a very minimum, Senator, we need to send a signal that there is going to be authorization to sell $15 billion in bonds, period. That is the very minimum today that we need. This is particularly true in light of the recent GAO opinion on FSLIC's insolvency. And I have been saying that over and over and over and I'm really not going to stop saying that because I couldn't be responsible saying anything else.

Senator GARN. Well, I would assume that we will not do that and that would mean that in 1 year we'll be back. If we do $7.5 billion all we've said to ourselves is we're going to defer the problem and in 1 year we'll have to come back and do it over again.

Mr. GRAY. That's right. Since last fall when the Garn-St Germain Act emergency authorities were not renewed, we sent letters and we tried very hard to get an extension. But we are still without that extra ordinary authority that we need.

Now I'm looking down a year or two from now. What is going to happen then? Are we going to be subject to the same kinds of delays? I'm concerned about that.

We have not had any banking legislation passed in the Congress since the fall of 1982. Here we are in 1987. This agency has gone through a tremendously difficult period and we have attempted to deal with our problems, but we still don't have much-needed legislation.

I think what we ought to be doing is sending a signal to the financial community: Yes, there is a plan; yes, we are going to bite the bullet, we are going to provide recapitalization, we're going to make it work. We're going to have exit fees that make it work. It won't work with the level of exit fees that we have in that House bill. We're going to have exit fees that work. We're not going to use forbearance to stop us from closing hopelessly insolvent institutions and protect savings and loan operators. We're not going to do these things if we really mean business about getting at this problem.

But thus far, I have to be honest here, I don't see that happening and I'm very concerned about it.

Senator GARN. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Garn.

Ms. Burkhart, Senator Garn called your agency and the credit union's a shining star. You do have your international headquarters in Madison, WI, I'm proud and happy to say.

Ms. BURKHART. One of the trade associations is in Madison. The agency's main office is here in Washington, DC.

The CHAIRMAN. So they are a shining star.

Senator GARN. Is that where the star shines?

The CHAIRMAN. Especially, you bet. [Laughter.]

But there's one disturbing development for credit unions that you note very clearly in your statement I'd like to ask you about.

You say on page 8, and I quote:

> Although less than 1 percent of credit union assets were devoted to business loans in 1985, 30 percent of those were problem loans compared to 2 percent for all other loans to members. Review of problem cases showed inadequate loan policies, underwriting standards, documentation and collateral, and poor monitoring and collection procedures. There was also a lack of portfolio diversification.

Now I must share with you the deep reservations that you express here about credit unions getting into that area. Without a sound business plan and experienced loan officers institutions can get into a lot of trouble quickly by making commercial loans.

What does the NCUA regulation say on this issue and what were the objections of credit union managers and how does NCUA intend to examine and supervise that activity?

Ms. BURKHART. Well, this problem of commercial lending or member business loans as we call them is one that the regulation is going to address as you indicated, it will require a certain level of diversification; a written business plan which will prohibit insider dealings; because, although they are few in number, most of the problem credit unions that we have had to merge or less frequently liquidate have gotten into trouble primarily because of insider abuse.

The CHAIRMAN. In one section in New York, you had $50 million of losses.

Ms. BURKHART. Yes, sir. That one very clearly was.

The CHAIRMAN. Was that insider borrowing?

Ms. BURKHART. Preferential treatment to close relatives and that type of thing. Yes, it was insider abuse.

What we hope to do and what we've already started doing is increasing the expertise of our examiners by sending them to commercial lending school at the Banking School of the South. We also have called upon the OCC to share their resources that is their expertise on business loans.

The CHAIRMAN. Have you considered the possibility of just getting out of business loans and leaving that to the banks? They have the professional people and they have the experience. They're doing a good job. Why should credit unions get into it at all?

Ms. BURKHART. Well, we have the problem of excess liquidity right now. So one of the things that happens quite often is that the institutions find ways of getting involved in things that they really shouldn't be in. There is no real prohibition in the Federal Credit Union Act against business loans.

The CHAIRMAN. How would you feel about Congress putting a prohibition in the act? Would you favor it or oppose it?

Ms. BURKHART. At this point, Senator, I think the horse is already out of the barn and it's going to be very difficult to bring everybody back in. But I believe that with proper supervision——

The CHAIRMAN. Well, they constitute less than 1 percent of your assets devoted to business loans. That was 1985. It may be bigger than that now.

Ms. BURKHART. Right. It has increased. Actually, we think that with the regulation we have put on the books, we will be able to control—with the additional staff and the additional training—and supervise that particular activity.

The CHAIRMAN. Let me ask you this. I notice that the number and volume of problem credit unions is rising and I wonder if this reflects the growing consumer debt burden. Why are problem credit union indicators rising and what are you doing about it?

PROBLEM CREDIT UNIONS ARE RISING

Ms. BURKHART. Well, it's a combination of factors. First, it's that we are recognizing them faster because of the increase in the examiner force and the training they receive. So they are better able to detect problems very early on.

Second, the increase has been primarily in those areas where there has been significant exposure in the agriculture and petroleum industries. Credit unions are not sheltered in any way from the economic difficulties of the various regions. As a matter of fact, the increase has been particularly in what we might call the midsection of the Nation, the farm States and the energy States.

The CHAIRMAN. But not in Wisconsin.

Mr. Gray, in the past and in your written testimony today you've said that fraud is a major cause of many thrift failures.

Don't independent public accounting firms audit the financial statements for these thrifts and shouldn't they be catching more of the fraud?

For example, why didn't the public accounting firms uncover the fraud in many of these problem institutions sooner of some of the failing thrifts, for instance, in Texas?

Mr. GRAY. I probably ought to answer this for the record, but I think my recollection is correct. In some cases, we did get indications from some accounting firms of evidence of these problems.

However, by and large, the way we detect this is through examination and through strong supervision. I think we're going to have to rely on that in any circumstance.

The CHAIRMAN. Is the Home Loan Bank Board at the present time satisfied with the work of public accounting firms that are presently engaged in auditing FSLIC-insured thrifts?

Mr. GRAY. Well, I would have to be honest and tell you there are occasions when we're not happy with that.

The CHAIRMAN. Well, let me ask you this. Have you ever barred or does the agency plan to bar any public accounting firms for poor quality audits of FSLIC-insured thrifts?

Mr. GRAY. Well, we have already singled out some in our own minds. I don't think it would be appropriate to go further than that.

The CHAIRMAN. I'm not asking you to name them. I'm just asking you whether or not you think it would be a good policy to, when you single them out, to say that at a certain point that's it, we're going to get somebody else that can do this job fully and accurately and responsibly.

Mr. GRAY. Yes, I have talked about that on a number of occasions with people at the Office of Regulatory Policy Oversight and Supervision, and there have been several firms that we have specifically discussed, but we haven't gone beyond that.

The CHAIRMAN. You haven't gone beyond that as yet. Do you think it would be a good idea for you to proceed?

Mr. GRAY. Well, I will need more information myself before we finally do that, but there's certainly reason to consider further action.

The CHAIRMAN. Due to the fact that fraud is a major cause of many thrift failures and the fact that some of these accounting

firms are not doing a satisfactory job, it would seem to me that a policy at some point of saying a firm that has not measured up is disqualified.

Mr. GRAY. Yes, I agree. I agree, but let me say that a good deal of the fraud, Mr. Chairman, that we have seen went undetected—not all, but a good deal went undetected back when we had insufficient examiners. Now that doesn't really address the matter of CPA firms, but the reason we know that there is such a good deal of fraud involved in these failures is because we have been able, with the increase in expertise and number of examiners and supervisors, to detect it.

The CHAIRMAN. I have just one more question. I see the total number of problem institutions has declined since 1984. Have we hit bottom regarding the sheer number of problem thrift institutions? Is it safe to say that you have uncovered the majority of already existing problem loans on the books of thrift institutions under your agency's jurisdiction?

Mr. GRAY. I think we have made a great deal of progress in finding these kinds of problems and certainly many of these problems are the residual effect of the excesses in 1983 and 1984, Mr. Chairman. I think because we have tripled our supervision and more than doubled our examination force that we are much more on top of these kinds of problems than we were before. In that connection, I know there was a good deal of discussion about the concerns with OMB and OPM oversight and control. The effects of OMB's intransigence with respect to not providing the kind of help we needed, and repeatedly requested, have been adverse in the extreme.

There's one thing this Congress could do to help the Bank Board and the FSLIC that's possibly as important as any other thing I can think of, including recapitalization, for the long term. And that is, to treat the Federal Home Loan Bank Board and the FSLIC in precisely the way you have treated the FDIC under the law. Let's assume that we get away from the Gramm-Rudman kind of constraints. The best thing you could do for the Bank Board, the thrift industry, and this system in the years to come, would be to eliminate the constraints imposed on us by the Office of Personnel Management and the Office of Management and Budget and make us just like the FDIC. The best thing you could bequeath to my successor would be precisely that because the longer we are under these kinds of constraints, the more difficult it's going to be for my successors to deal with the kind of problems that we have.

The CHAIRMAN. Well, I appreciate that very much and, of course, Senator Garn has done a terrific job in that respect in his chairmanship of this committee over the past 6 years and he continues to make that point very well.

Senator Garn.

Senator GARN. I just have one question and when my time ran out before we had agreed that you thought the two-plus-two authority on exit fees was inadequate. I didn't get your answer as to what an adequate level of exit fees would be to maintain FSLIC's base.

Mr. GRAY. All right. When we're talking about two-plus-two, of course, we're talking about 2 year regular and 2 year special premiums. The way we got to these numbers—two-plus-two, three-

plus-three, four-plus-four, and on up—was by looking, from our agency's point of view, at the percentage of deposits that we would need to maintain the viability of that kind of recap plan.

Now I have said before that we need at a very minimum four-plus-four. I'm not comfortable with four-plus-four. I think it ought to be five-plus-five or six-plus-six. Of course you recognize that right now it's redundant to have another law affirming our authority to levy a two-plus-two exit fee. We already have two-plus-two authority under the law.

What we need is at least four-plus-four, but even if that happens, Senator, we're going to pay a lot more for those bonds than we ought to pay. The way that you provide comfort to potential bondholders is to demonstrate to them that in fact there will be for the 30-year length of these bonds an adequate revenue stream, an adequate premium stream to pay the interest on the bonds.

And how do you do that? You have to have an exit fee that either compensates the FSLIC for the loss of that revenue stream in a way that can maintain its viability or an institution stays in the FSLIC system or you don't really have a plan that works. Certainly it doesn't work very well.

So the long answer is we need more. We need at least four plus four period. Perhaps you wouldn't fashion it that way. Perhaps there is another way to fashion it. But you need at least four plus four and even then you're still going to pay a lot higher interest than you should on the bonds.

I would like to see—and I'll put it in the record—at least five plus five or six plus six. I think that's really what's needed. I know it's not politically popular, but it is needed if we want to make this play viable and keep it viable. We have to give comfort to potential bondholders that the interest payments are going to be met for the entire duration of the program. And how do we do that? We can't do that? We can't do that with a two plus two exit fee.

Senator GARN. Thank you, Chairman Gray. I hope you haven't scared Dan Hall to death so that he wants to withdraw his nomination for your position.

This will probably be the last time you will appear before this committee. I wish to thank you for your service to the Federal Home Loan Bank Board, for your cooperation with this committee, and for your cooperation with me while I was chairman of the committee. Thank you very much.

Mr. GRAY. Thank you very much.

Senator GARN. The committee is adjourned.

[Whereupon, at 1:05 p.m., the hearing was adjourned.]

[Additional material supplied for the record follows:]

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

WILLIAM PROXMIRE, WISCONSIN, CHAIRMAN
ALAN CRANSTON, CALIFORNIA
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JAKE GARN, UTAH
JOHN HEINZ, PENNSYLVANIA
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M. DANNY WALL, MINORITY STAFF DIRECTOR

United States Senate
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
WASHINGTON, DC 20510-6075

April 9, 1987

Honorable Paul A. Volcker
Chairman, Board of Governors
Federal Reserve System
20th & C St. N.W.
Washington, D.C. 20551

Dear Chairman Volcker:

The Senate Banking Committee will convene hearings on the "Financial Condition of Federally Insured Depository Institutions" at our earliest opportunity in May. To assist the Committee in the exercise of its oversight responsibilities, I request that the Federal Reserve Board coordinate the collection of the information listed below from the appropriate regulatory agencies and provide the information to the Committee on or before May 11, 1987.

It is requested that the information provided be on an annual basis, and that the data provided be as consistent as possible from year to year. If definitions, coverage, etc. have changed, please indicate the time period in which the change occurred. The depository institution data should be grouped according to size categories that appropriately include multinational, large regional, other regional, and community institutions. To enhance the presentation and discussion of the data, please arrange the data in a uniform fashion so as to permit comparability between the different types of financial institutions.

Please provide, for the years 1970 to the present, the following information with respect to federally insured banks, thrift institutions, and credit unions, and with respect to bank holding companies:

1. Number and total assets;

2. Number and total assets of institutions failed or absorbed to avert failure;

3. Number and total assets of troubled (CAMEL rating of 4 and 5 and pre-CAMEL equivalents) institutions;

4. Nonperforming loans and leases as a percent of total assets;

5. Problem assets (defined as 20% of substandard, 50% of doubtful and all loss assets) as a percent of total assets;

6. Primary capital of federally insured institutions as a percent of (1) total assets, and (2) total assets plus off-balance sheet obligations (We are aware that the Call Report provides only limited information on bank off-balance sheet obligations. An inspection of the annual reports of the money center banks, however, indicates that standby letters of credit constitute only about 5 percent of their off-balance sheet obligations. A full response to this question should include the information from sources in addition to the Call Report, as appropriate, in light of the new risk-based capital proposal);

7. Primary capital less problem assets (defined as above) as a percent of (1) total assets, and (2) total assets plus off-balance sheet obligations (as treated above);

8. Short-term assets less large liabilities as a percent of total assets;

9. Purchased funds and brokered deposits as a percent of total assets;

10. Net interest margin as a percent of average earning assets;

11. Return on total assets;

12. Net income as a percent of equity capital;

13. Number of examiners and their turnover ratio for each of the supervisory agencies;

14. Number of examiner manhours as a percent of total deposits for each of the supervisory agencies;

15. Number and total assets of thrift institutions broken down by positive and negative net worth institutions;

16. For bank and thrift holding companies, equity invested in subsidiaries as a percent of total bank equity (double leveraging ratio); and

17. Foreign, federal, state and local taxes paid as a percent of net income.

In addition to the above information, please provide any other data you feel would augment the Committee's understanding of the current financial condition of federally insured depository institutions.

My staff is available to discuss this request with you.

I look forward to and appreciate your cooperation in meeting the information needs of the Committee.

Sincerely,

William Proxmire
Chairman

WILLIAM PROXMIRE, WISCONSIN, CHAIRMAN
ALAN CRANSTON, CALIFORNIA
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United States Senate
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
WASHINGTON, DC 20510-6075

May 6, 1987

Hon. Paul A. Volcker
Chairman
Board of Governors
Federal Reserve System
20th & Constitution, N.W.
Washington D.C. 20551

Dear Mr. Chairman:

To assist the Senate Committee on Banking, Housing, and Urban Affairs in the exercise of its oversight responsibilities, you are requested to appear before the Committee on May 21, 1987, at 10:00 a.m., in Room 538 of the Dirksen Senate Office Building, to testify on the financial condition of the institutions under the jurisdiction of your agency. In your testimony, please provide the Committee with a thorough overview of their current financial condition and respond specifically to the questions below.

1. Capital: Are current levels of capital, including consideration of classified assets and off-balance sheet items, adequate? How do current capital levels compare with levels in previous years? Regarding each of the ten largest bank holding companies, what is the current level of risk-based capital, and is this level up or down from last year? What is "double-leveraging", and what are its implications for assessing bank and bank holding company capital adequacy?

2. Assets: How sensitive is asset quality to national and international economic conditions? What is the current level of asset quality, and how has it been affected in recent decades by successive periods of recession and recovery? With regard to agricultural, international, energy, and real estate lending, what are present conditions, and how do they compare with those of recent years? With regard to letters of credit and other off-balance sheet items, what are the amounts of these items, and how are these trends explained? With regard to loan "securitization", how is this activity measured, to what extent is it being engaged in, and will it reduce the average quality of loans retained by banks in portfolio?

3. Earnings: What are the current levels of bank and bank holding company earnings with respect both to equity and to total assets, and how do these levels compare with those of years past? What portion of the earnings of the ten largest bank holding companies consist of non-interest income, i.e. fee-based income, trading account profits, gains on investment securities, etc.?

4. Liquidity: How do current liquidity levels, particularly in the form of uninsured and short-term borrowed funds, compare with those of previous years? What has been the impact of the increased use of brokered deposits?

5. Problem Institutions: What is the present number of so-called "problem institutions"? What is the amount of total deposits held by these institutions? What supervisory actions are being taken in response to the trend in the number of "problem institutions"?

6. Failed Institutions: How many institutions have had to be liquidated, merged, or assisted to avert failure so far this year? How does this number compare with those in previous years? Do you expect this trend to continue?

7. Examiners: How many bank and bank holding company examiners does your agency employ? How does this number compare with those of previous years? Do you feel the examiner workforce under your purview is adequate?

In addition to the above information, please provide any other testimony you feel would augment the Committee's understanding of the current financial condition of the banks under your agency's jurisdiction.

In accordance with Committee Rules, please deliver 100 copies of your prepared statement to Room 534 Dirksen twenty-four hours in advance of your scheduled appearance before the Committee. To provide all Committee Members sufficient time for questioning, the oral presentation of your testimony should be limited to ten minutes.

I look forward to your appearance before the Committee.

Sincerely,

William Proxmire
Chairman

WILLIAM PROXMIRE, WISCONSIN, CHAIRMAN
ALAN CRANSTON, CALIFORNIA
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JOHN H. CHAFEE, RHODE ISLAND
KENNETH A. McLEAN, STAFF DIRECTOR
M. DANNY WALL, MINORITY STAFF DIRECTOR

United States Senate
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
WASHINGTON, DC 20510-6075

May 6, 1987

Hon. Robert L. Clarke
Comptroller of the Currency
Department of the Treasury
490 L'Enfant Plaza East, S.W.
Washington, D.C. 20219

Dear Mr. Clarke:

To assist the Senate Committee on Banking, Housing, and Urban Affairs in the exercise of its oversight responsibilities, you are requested to appear before the Committee on May 21, 1987, at 10:00 a.m., in Room 538 of the Dirksen Senate Office Building, to testify on the financial condition of the federally insured depository institutions under the jurisdiction of your agency. In your testimony, please provide the Committee with a thorough overview of their current financial condition and respond specifically to the questions below.

1. Capital: Are current levels of capital, including consideration of classified assets and off-balance sheet arrangements, adequate? How do current capital levels compare with levels in previous years? Regarding each of the ten largest national banks, what is the current level of risk-based capital and is this level up or down from last year? What is "double-leveraging", and what are its implications for assessing bank capital adequacy?

2. Assets: How sensitive is asset quality to national and international economic conditions? What is the current level of asset quality, and how has it been affected in recent decades by successive periods of recession and recovery? With regard to agricultural, international, energy, and real estate lending, what are present conditions, and how do they compare with those of recent years? With regard to letters of credit and other off-balance sheet items, what are the amounts of these items, and how are these trends explained? With regard to loan "securitization", how is this activity measured, to what extent is it being engaged in, and will it reduce the average quality of loans retained by banks in portfolio?

3. Earnings: What are the current levels of bank earnings with respect both to equity and to total assets, and how do these levels compare with those of years past? What portion of the earnings of the ten largest national banks consist of non-interest income, i.e. fee-based income, trading account profits, gains on investment securities, etc.?

4. Liquidity: How do current liquidity levels, particularly in the form of uninsured and short-term borrowed funds, compare with those of

previous years? What has been the impact of the increased use of brokered deposits?

5. Problem Institutions: What is the present number of so-called "problem institutions"? What is the amount of total deposits held by these institutions? What supervisory actions are being taken in response to the trend in the number of "problem institutions"?

6. Failed Institutions: How many institutions have had to be liquidated, merged, or assisted to avert failure so far this year? How does this number compare with those in previous years? Do you expect this trend to continue?

7. Examiners: How many bank examiners does your agency employ? How does this number compare with those of previous years? Do you feel the examiner workforce under your purview is adequate?

In addition to the above information, please provide any other testimony you feel would augment the Committee's understanding of the current financial condition of the banks under your agency's jurisdiction.

In accordance with Committee Rules, please deliver 100 copies of your prepared statement to Room 534 Dirksen twenty-four hours in advance of your scheduled appearance before the Committee. To provide all Committee Members sufficient time for questioning, the oral presentation of your testimony should be limited to ten minutes.

I look forward to your appearance before the Committee.

Sincerely,

William Proxmire
Chairman

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M. DANNY WALL, MINORITY STAFF DIRECTOR

United States Senate
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
WASHINGTON, DC 20510-6075

May 6, 1987

Hon. L. William Seidman
Chairman
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429

Dear Mr. Chairman:

To assist the Senate Committee on Banking, Housing, and Urban Affairs in the exercise of its oversight responsibilities, you are requested to appear before the Committee on May 21, 1987, at 10:00 a.m., in Room 538 of the Dirksen Senate Office Building, to testify on the financial condition of federally insured depository institutions under the jurisdiction of your agency. In your testimony, please provide the Committee with a thorough overview of their current financial condition and respond specifically to the questions below.

1. Capital: Are current levels of capital, including consideration of classified assets and off-balance sheet arrangements, adequate? How do current capital levels compare with levels in previous years? What is "double-leveraging", and what are its implications for assessing bank capital adequacy?

2. Assets: How sensitive is asset quality to national and international economic conditions? What is the current level of asset quality, and how has it been affected in recent decades by successive periods of recession and recovery? With regard to agricultural, international, energy, and real estate lending, what are present conditions, and how do they compare with those of recent years? With regard to letters of credit and other off-balance sheet items, what are the amounts of these items, and how are these trends explained? With regard to loan "securitization", how is this activity measured, to what extent is it being engaged in, and will it reduce the average quality of loans retained by banks in portfolio?

3. Earnings: What are the current levels of bank earnings with respect both to equity and to total assets, and how do these levels compare with those of years past? What portion of the earnings of the ten largest federally insured banks consist of non-interest income, i.e. fee-based income, trading account profits, gains on investment securities, etc.?

4. Liquidity: How do current liquidity levels, particularly in the form of uninsured and short-term borrowed funds, compare with those of previous years? What has been the impact of the increased use of brokered deposits?

5. Problem Institutions: What is the present number of so-called "problem institutions"? What is the amount of total deposits held by these institutions? What supervisory actions are being taken in response to the trend in the number of "problem institutions"?

6. Failed Institutions: How many institutions have had to be liquidated, merged, or assisted to avert failure so far this year? How does this number compare with those in previous years? Do you expect this trend to continue?

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In addition to the above information, please provide any other testimony you feel would augment the Committee's understanding of the current financial condition of the banks under your agency's jurisdiction.

In accordance with Committee Rules, please deliver 100 copies of your prepared statement to Room 534 Dirksen twenty-four hours in advance of your scheduled appearance before the Committee. To provide all Committee Members sufficient time for questioning, the oral presentation of your testimony should be limited to ten minutes.

I look forward to your appearance before the Committee.

Sincerely,

William Proxmire
Chairman

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

PAUL A. VOLCKER
CHAIRMAN

May 15, 1987

The Honorable William Proxmire
Chairman
Committee on Banking, Housing and
Urban Affairs
United States Senate
Washington, D.C. 20510-6075

Dear Chairman Proxmire:

In response to your letter of April 9, a packet of tables is enclosed providing information you requested from the three bank regulatory agencies. As also requested, this information has been assembled by the Board's staff. By agreement with your staff and with the staff of the Federal Home Loan Bank Board and National Credit Union Association, information you requested from these agencies is being sent to you under separate cover.

I hope the enclosed material will assist the committee in its deliberations.

Sincerely,

Paul A. Volcker

Enclosures

Information Provided

by the

Federal Reserve Board,

Federal Deposit Insurance Corporation

and Office of the Comptroller of the Currency

to the

Senate Banking Committee

As requested by Chairman Proxmire for the Committee's May 21, 1987 hearings on the Financial Condition of Federally Insured Depository Institutions.

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As discussed with Senate Banking Committee staff, Call Report data provide information on tax liability before adjustments for tax carry forwards, carrybacks, etc. Thus data does not reflect taxes paid and by agreement with staff is not being provided.

Question 1

Table 1

Number

Insured Commercial Banks

As of Year End	Assets Size: Less than $300 Million	$300 Million-$1 Billion	Greater than $1 Billion Except Top 25	Top 25	Total
1986	13,233	543	310	25	14,111
1985	13,542	504	286	25	14,357
1984	13,717	467	249	25	14,458
1983	13,757	444	228	25	14,454
1982	13,815	393	204	25	14,437
1981	13,825	372	180	25	14,402
1980	13,883	349	165	25	14,422
1979	13,862	316	148	25	14,351
1978	13,918	297	138	25	14,378
1977	13,975	278	119	25	14,397
1976	14,020	250	101	25	14,396
1975	14,012	246	89	25	14,372
1974	13,869	234	89	25	14,217
1973	13,636	227	77	25	13,965
1972	13,428	204	65	25	13,722
1971	13,348	171	59	25	13,603
1970	13,281	148	48	25	13,502

Source: Call Reports

Question 1

Table 2

Total Assets

Insured Commercial Banks

($ in Billions)

As of Year End	Assets Size: Less than $300 Million	$300 Million-$1 Billion	Greater than $1 Billion Except Top 25	Top 25	Total
1986	706.1	273.8	972.4	971.6	2,923.9
1985	690.2	257.3	844.4	926.6	2,718.5
1984	674.5	241.2	708.7	874.3	2,498.7
1983	647.0	228.0	604.0	854.0	2,333.0
1982	611.7	205.5	519.0	850.3	2,186.5
1981	575.1	196.9	444.4	805.8	2,022.2
1980	538.7	180.0	383.6	747.1	1,849.4
1979	506.1	165.4	334.3	680.4	1,686.2
1978	474.0	151.6	284.1	593.8	1,503.5
1977	441.5	141.9	229.6	522.2	1,335.2
1976	405.1	129.5	189.1	455.2	1,178.9
1975	378.1	128.7	164.6	411.7	1,083.1
1974	349.5	120.9	160.4	403.3	1,034.1
1973	328.1	120.2	142.2	345.7	936.2
1972	300.8	110.9	112.6	279.2	803.5
1971	271.8	90.3	92.2	233.1	687.4
1970	248.1	80.7	71.5	207.9	608.2

Source: Call Reports

Question 1

Table 3

Number of Bank Holding Companies

As of Year End	Assets Size					
	0 - 150MM	150MM - $300MM	$300 MM- $1 Billion	$1 Billion Except Top 25	Top 25	Total
1986	5,565	393	253	229	25	6,465
1985	5,569	371	260	228	25	6,453
1984	5,309	342	247	223	25	6,146
1983	4,622	273	237	214	25	5,371
1982	3,924	208	207	193	25	4,557
1981	3,130	153	161	175	25	3,644
1980	2,603	114	155	160	25	3,057
1979	2,095	102	144	154	25	2,520
1978	1,818	98	137	144	25	2,222
1977	1,642	97	142	128	25	2,034
1976	1,541	95	131	121	25	1,913

Source: FR Y-9C and FR Y-6

Question 1

Table 4

Total Assets

Bank Holding Companies

($ in Billions)

As of Year End	Asset Size $150MM - $300MM	$300MM - $1 Billion	$1 Billion Except Top 25	Top 25	Total
1986	81.5	131.6	1,058.0	1,232.6	2,503.7
1985	78.2	136.7	962.8	1,135.1	2,312.8
1984	71.6	134.0	813.7	1,060.4	2,079.7
1983	56.3	129.9	705.9	999.0	1,891.1
1982	43.0	116.0	616.2	962.9	1,738.1
1981	32.2	92.6	514.9	894.2	1,533.9
1980	23.4	85.9	446.2	824.4	1,379.9
1979	21.2	79.5	404.9	742.2	1,247.8
1978	20.7	76.6	357.4	644.7	1,099.4
1977	20.5	81.2	298.0	563.9	963.6
1976	20.3	73.3	256.0	491.4	841.0

Footnote: Bank holding companies that have less than $150 million are not required to file consolidated financial statements. These companies file parent only financial statements.

Source: FR Y-9C and FR Y-6

Question 2

TABLE 1
OPEN AND CLOSED BANK ASSISTANCE BY FDIC
(COMMERCIAL BANKS AND THRIFTS)
(000 omitted)

Year-End	0 - $300 Million		$300 - $1,000 Million		Over $1 Billion		Total	
	#	Total Assets	#	Total Assets	#	Total Assets	#	Total Assets
1986	142	5,008,665	2	1,061,013	1	1,616,816	145	7,686,494
1985	118	3,049,848	1	413,948	1	5,277,472	120	8,741,268
1984	78	2,371,211	2	905,200	1	35,900,000	81	39,176,411
1983	45	2,344,397	1	778,434	2	3,904,092	48	7,026,923
1982	33	954,849	6	4,139,842	3	6,537,724	42	11,632,451
1981	7	260,060	1	899,000	2	3,700,000	10	4,859,060
1980	10	236,164			1	5,500,000	11	5,736,164
1979	10	132,988					10	132,988
1978	6	281,495	1	712,540			7	994,035
1977	6	232,612					6	232,612
1976	15	627,186	2	$762,107			17	1,389,293
1975	13	419,950					13	419,950
1974	4	316,934			1	3,655,662	5	3,972,596
1973	5	43,807			1	1,265,868	6	1,309,675
1972	1	22,054			1	$1,300,000	2	1,322,054
1971	7	205,820					7	205,820
1970	7	$62,147					7	$62,147

Question 2

TABLE 2
FDIC INSURED - CLOSED BANKS - BY SIZE
(000 omitted)

Year-End	0 - $300 Million		$300 - $1,000 Million		Over $1 Billion		Total	
	#	Total Assets	#	Total Assets	#	Total Assets	#	Total Assets
1986	135	4,287,971	2	1,061,013	1	1,616,816	138	6,965,800
1985	116	2,851,969					116	2,851,969
1984	78	2,371,211	1	391,800			79	2,763,011
1983	43	1,954,397	1	778,434	1	1,404,092	45	4,136,923
1982	30	1,530,573	2	962,842			32	2,493,415
1981	7	260,060					7	260,060
1980	10	236,164					10	236,164
1979	10	132,988					10	132,988
1978	6	281,495	1	712,540			7	994,035
1977	6	232,612					6	232,612
1976	15	627,186	1	$412,107			16	1,039,293
1975	13	419,950					13	419,950
1974	3	166,934			1	3,655,662	4	3,822,596
1973	5	43,807			1	$1,265,868	6	1,309,675
1972	1	22,054					1	22,054
1971	6	196,520					6	196,520
1970	7	$62,147					7	$62,147

Question 2

TABLE 3
FDIC INSURED BANKS - OPEN BANK ASSISTANCE - BY SIZE
(000 omitted)

Year-End	Under $300 Million		$300 - $1,000 Million		Over $1 Billion		Total	
	#	Total Assets	#	Total Assets	#	Total Assets	#	Total Assets
1986	6	220,694	1	500,000			7	720,694
1985	2	197,879	1	492,420	1	5,200,000	4	5,890,299
1984			1	513,400	1	35,900,000	2	36,413,400
1983	2	390,000			1	2,500,000	3	2,890,000
1982	2	206,000	5	3,533,000	3	5,400,000	10	9,139,000
1981			1	899,000	2	3,700,000	3	4,599,000
1980					1	5,500,000	1	5,500,000
1979								
1978								
1977								
1976			1	$350,000			1	350,000
1975								
1974	1	150,000					1	150,000
1973								
1972					1	$1,300,000	1	1,300,000
1971	1	$9,300					1	$9,300
1970								

Question 3

TABLE 1
Number and total deposits of troubled (CAMEL rating of 4 and 5 and pre-CAMEL equivalents) institutions:

TOTAL NUMBER OF FDIC-INSURED PROBLEM
COMMERCIAL BANKS AND THRIFTS AND AGGREGATE
TOTAL DEPOSITS BY YEAR

Year-End	0 - $300 Million		$300 - $1,000 Million		Over $1 Billion		Total	
	#	Deposits	#	Deposits	#	Deposits	#	Deposits
1986	1,412	$54,915	46	$24,348	26	$191,683	1,484	$270,946
1985	1,069	41,317	41	23,217	30	132,593	1,140	197,127
1984	778	31,031	38	20,129	32	134,949	848	186,109
1983	591	26,828	31	16,513	20	85,740	642	129,081
1982	332	12,759	21	10,119	16	34,460	369	57,338
1981	197	5,659	15	9,423	11	27,482	223	42,564
1980	206	4,599	7	4,860	4	12,185	217	21,644
1979	274	6,995	11	6,559	2	6,763	287	20,317
1978	322	8,404	14	7,668	6	48,069	342	64,142
1977	348	10,036	13	7,307	7	44,561	368	61,904
1976	361	11,286	10	6,037	8	41,830	379	59,153
1975	340	9,971	7	3,955	2	6,517	349	20,443
1974	177	4,525	5	3,116	1	1,420	183	9,061
1973	154	3,107	2	1,499	0	0	156	4,036
1972	189	3,141	3	2,192	0	0	192	5,333
1971	239	3,504	2	1,453	0	0	241	4,957
1970	251	3,613	0	0	1	1,075	252	4,689

Deposit amounts are shown in $Million.

Source: FDIC Problem Bank List.

Question 3

Table 2

Number and Total Assets of Bank Holding Companies Rated Composite 4 or 5

Reporting Bank Holding Companies

As of Year-End	Assets Size: Less than $300 Million	$300 Million-$1 Billion	Greater than $1 Billion	All Bank Holding Companies	
	No.	No.	No.	No.	Total Assets
1986	437	14	14	465	$240
1985	282	13	10	305	232
1984	158	8	7	173	72
1983	121	6	4	131	21
1982	52	3	6	61	20
1981	23	3	7	33	48
1980	30	3	6	39	42
1979	27	6	7	40	31

1/ Bank Holding Company ratings have been collected since 1979.
2/ Dollar signs in Billions

Source: Bank Holding Company Inspection Reports.

Question 4

REVISED

Table 1

Nonperforming Loans and Leases as a Percentage of Total Assets

Insured Commercial Banks

	Asset Size			
As of Year End	Less than $300 Million	$300 Million-$1 Billion	Greater than $1 Billion Except 25	Top 25
1986	2.09	1.90	1.49	2.34
1985	2.09	1.70	1.59	2.25
1984	1.79	1.55	1.77	2.66
1983	1.64	1.68	1.92	2.66
1982	1.63	1.90	2.06	2.41

1/ Nonperforming loans and leases include data on loans and leases 90 days or more past due and still accruing and loans and leases on nonaccrual status. Data for 1986 do not include renegotiated troubled debt that is in conformance with modified terms.

Source: Call Report

Question 4

Table 2

Nonperforming Loans and Leases as a Percentage of Total Assets

Reporting Bank Holding Companies

As of Year End	Asset Size: Greater than $150 Million But Less than $300 Million	$300 Million-$1 Billion	Greater than $1 Billion Except 25	Top 25
1986	1.98	2.16	1.62	2.35
1985	2.09	2.19	1.54	2.53

1/ Nonperforming loans and leases include data on loans and leases 90 days or more past due and still accruing and loans and leases in nonaccrual status.

Data for 1986 do not include renegotiated troubled debt that is in conformance with modified terms.

Source: FR Y-9C

Question 5

Table 1

Problem Assets as a Percent of Total Assets

Insured Commercial Banks

As of Year End	Asset Size: Less than $300 Million	$300 Million-$1 Billion	Greater than $1 Billion Except Top 25	Top 25
1986	1.00	0.75	0.68	1.22
1985	0.96	0.66	0.75	1.23
1984	0.83	0.63	0.79	1.31
1983	0.77	0.73	0.88	1.21
1982	0.69	0.73	0.75	0.83
1981	0.51	0.49	0.49	0.53
1980	0.44	0.45	0.46	0.49
1979	0.39	0.40	0.40	0.59
1978	0.39	0.42	0.53	0.75

Footnote: Problem assets defined as 20% of substandard, 50% of doubtful, and 100% of loss are from examination data. In some instances, the results of targeted and limited scope examinations do not reflect a review of the complete asset portfolio.

Source: Examination records of the FRB, OCC and FDIC.

Question 6

Table 1

Equity plus Loan Loss Reserves as a Percent of Total Assets

Insured Commercial Banks

As of Year End	Asset Size: Less than $300 Million	$300 Million-$1 Billion	Greater than $1 Billion Except 25	Top 25
1986	8.72	7.67	6.87	6.22
1985	8.78	7.87	6.66	5.88
1984	8.68	7.48	6.50	5.65
1983	8.64	7.35	6.38	5.18
1982	8.69	7.37	6.27	4.78
1981	8.65	7.37	6.31	4.59
1980	8.60	7.37	6.25	4.50
1979	8.43	7.14	6.33	4.48
1978	8.22	7.11	6.33	4.62
1977	8.09	7.21	6.48	4.81
1976	8.23	7.39	6.62	5.03
1975	8.24	7.52	6.81	5.05
1974	8.25	7.36	6.58	4.71
1973	7.97	7.23	6.39	4.96

Source: Call Report

Question 6

Table 2

Equity plus Loan Loss Reserves as a Percent of Total Assets plus Standby Letters of Credit

Insured Commercial Banks

	Asset Size			
As of Year End	Less than $300 Million	$300 Million-$1 Billion	Greater than $1 Billion Except 25	Top 25
1986	8.67	7.55	6.61	5.53
1985	8.72	7.75	6.38	5.15
1984	8.63	7.37	6.26	5.01
1983	8.58	7.25	6.17	4.68
1982	8.64	7.26	6.09	4.38
1981	8.61	7.26	6.18	4.29
1980	8.57	7.29	6.15	4.29
1979	8.40	7.09	6.25	4.31
1978	8.20	7.06	6.26	4.46
1977	8.07	7.16	6.41	4.67
1976	8.22	7.35	6.57	4.90
1975	8.23	7.48	6.75	4.94
1974	8.24	7.53	6.52	4.62
1973	7.96	7.20	6.33	4.91

Source: Call Report

Question 6

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Table 3

Primary Capital as a Percent of Total Assets

Insured Commercial Banks

As of Year End	Asset Size: Less than $300 Million	$300 Million-$1 Billion	Greater than $1 Billion Except 25	Top 25
1986	8.73	7.69	6.98	6.80
1985	8.78	7.88	6.76	6.47
1984	8.68	7.49	6.50	5.66
1983	8.64	7.25	6.42	5.18
1982	8.69	7.26	6.27	4.78
1981	8.65	7.26	6.31	4.59
1980	8.60	7.29	6.25	4.50
1979	8.43	7.09	6.33	4.48
1978	8.22	7.06	6.33	4.62
1977	8.09	7.16	6.48	4.81
1976	8.23	7.35	6.62	5.03
1975	8.24	7.48	6.81	5.08
1974	8.26	7.33	6.59	4.73
1973	7.97	7.23	6.39	4.97

1/ Primary capital includes common stock, perpetual preferred stock, qualifying mandatory convertible debentures, minority interest in unconsolidated subsidiaries, and the allowance for loan and lease losses.

Source: Call Report

Question 6

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Table 4

Primary Capital as a Percent of Total Assets Plus Standby Letters of Credi

Insured Commercial Banks

As of Year End	Asset Size: Less than $300 Million	$300 Million-$1 Billion	Greater than $1 Billion Except 25	Top 25
1986	8.68	7.57	6.71	6.04
1985	8.73	7.76	6.48	5.67
1984	8.63	7.38	6.26	5.02
1983	8.58	7.25	6.21	4.68
1982	8.64	7.26	6.09	4.38
1981	8.61	7.26	6.18	4.29
1980	8.57	7.26	6.15	4.28
1979	8.40	7.09	6.25	4.31
1978	8.20	7.06	6.26	4.46
1977	8.07	7.16	6.41	4.67
1976	8.22	7.35	6.57	4.90
1975	8.24	7.48	6.75	4.97
1974	8.24	7.33	6.52	4.64
1973	7.96	7.20	6.34	4.92

1/ Primary capital includes common stock, perpetual preferred stock, qualifying mandatory convertible debentures, minority interest in unconsolidated subsidiaries, and the allowance for loan and lease losses.

Source: Call Report

Question 6

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Table 5

Selected Capital - Asset Ratios (in percent)

Largest Insured Commercial Banks

As of Year End	Ratio 1	Ratio 2	Ratio 3	Ratio 4	Ratio 5	Ratio 6
			Top 10			
1986	6.15%	5.39%	5.21%	6.80%	5.96%	5.76%
1985	5.75%	4.96%	4.85%	6.37%	5.50%	5.38%
1984	5.57%	4.86%	4.78%	5.58%	4.87%	4.79%
1983	5.12%	4.55%	4.46%	5.12%	4.55%	4.46%
1982	4.66%	4.22%	4.27%	4.66%	4.22%	4.27%
1981	4.47%	4.14%	4.16%	4.47%	4.14%	4.16%
1980	4.37%	4.13%	4.13%	4.37%	4.13%	4.13%
1979	4.33%	4.13%	4.11%	4.33%	4.13%	4.11%
1978	4.46%	4.28%	4.32%	4.46%	4.28%	4.32%
1977	4.61%	4.45%	4.48%	4.61%	4.45%	4.48%
1976	4.80%	4.66%	4.68%	4.80%	4.66%	4.68%
			Top 25			
1986	6.22%	5.53%	5.35%	6.80%	5.97%	5.85%
1985	5.80%	5.15%	5.03%	6.47%	5.67%	5.54%
1984	5.65%	5.01%	4.91%	5.66%	5.02%	4.92%
1983	5.18%	4.68%	4.57%	5.18%	4.68%	4.57%
1982	4.78%	4.38%	4.42%	4.78%	4.38%	4.42%
1981	4.59%	4.29%	4.31%	4.59%	4.29%	4.31%
1980	4.50%	4.29%	4.28%	4.50%	4.28%	4.28%
1979	4.48%	4.31%	4.29%	4.48%	4.31%	4.29%
1978	4.62%	4.46%	4.49%	4.62%	4.46%	4.49%
1977	4.81%	4.67%	4.70%	4.81%	4.67%	4.70%
1976	5.03%	4.90%	4.93%	5.03%	4.90%	4.93%

Definitions:

Ratio 1: Equity plus Loan Loss Reserves/Total Assets
Ratio 2: Equity plus Loan Loss Reserves/Total Assets plus Standby Letters of Credit
Ratio 3: Equity plus Loan Loss Reserves/Total Assets plus Adjusted Off-Balance Sheet Items 1/
Ratio 4: Primary Capital/Total Assets
Ratio 5: Primary Capital/Total Assets plus Standby Letters of Credit
Ratio 6: Primary Capital/Total Assets plus Adjusted Off Balance Sheet Item 1/

Note: Adjusted off balance sheet items was obtained by summing the following items, weighted as indicated: standby letters of credit (80 percent of face value); commercial letters of credit (50 percent of face value); loan commitments (10 percent of face value) and interest rate swaps (5 percent of notional value). See attached page for explanation.

The data on certain off-balance sheet activities for insured commercial banks has been available for a limited period of time. The data on commercial letters of credit has been available since 1979; information of loan commitments has been available since 1983; and the data on interest rate swaps has been available since 1985.
Source: Call Reports

Question 6

Attachment to Table 5

Definition and Explanation of Adjusted Off-Balance Sheet Item

The following are included in the adjusted off-balance sheet item used in Ratios 3 and 6, weighted as indicated: standby letters of credit (80 per cent of face amount), commercial letters of credit (50 percent of face amount), loan commitments (10 percent of face amount) and interest rate swaps (5 per cent of notional amount). The weights were used to achieve a very rough consistency with the treatment of off-balance sheet items in the joint US/UK Risk-Based Capital Proposal.

More specifically, in the risk-based capital proposal, standby letters of credit that back financial obligations of customers, in effect, are generally given a 100 per cent weight (the same weight that would be given loans to these customers), while standby letters of credit backing a non-financial or commercial undertaking are generally given a weight of 50 per cent of face amount. Available data on standbys does not presently distinguish between financial and nonfinancial but it is known that the former account for a considerably larger share of the total than the latter. Against this background, it is judged that including 80 per cent of total standbys in the off-balance sheet measure used in the table roughly approximates the volume of standbys that would be included if the risk adjusted capital measure were followed.

In general commercial letters of credit are assigned a 50 per cent weight in the risk-based capital proposal, the same weight used in the table. The weight given to loan commitments in the agreed proposal varies from 10 to 50 per cent depending on the maturity of the commitment. Such maturity data are not currently available; but it is estimated that a significant proportion of commitments have maturities of one year or less, the maturity to which a 10 percent weight is given in the risk-adjusted measure. Since the proposal is still out for comment and the definition and treatment of commitments remains to to be determined, a 10 per cent weight was used in the measure for the table for simplicity.

Finally, a proposal on how to assign a risk weight to interest rate swaps in the risk-based capital measure is currently out for comment. This proposal involves an estimation procedure that attempts to take into account both the existing and potential credit risk of a swap position. For this purpose, credit risk is defined as the amount of loss that institutions would incur if partners with which they have swaps that are "in the money" were to default on their obligations. This credit risk will vary depending upon interest rate movements and resulting changes in "in the money" positions. The proposal thus envisions that the weight

Attachment to Table 5 Continued

assigned to swaps will vary over time, but our necessarily rough estimate is that 5 per cent of the notional amount is a reasonable proxy of the amount that will be specified if the proposal out for comment is adopted.

Question 6

Table 6

Equity plus Loan Loss Reserves as a Percent of Total Assets

Reporting Bank Holding Companies

As of Year End	Asset Size: Greater than $150 Million But Less than $300 Million	$300 Million-$1 Billion	Greater than $1 Billion Except 25	Top 25
1986	7.83	7.86	7.13	6.32
1985	7.79	7.61	6.94	5.86
1984	7.40	7.28	6.82	5.67
1983	7.35	7.24	6.81	5.40
1982	7.18	7.08	6.63	4.85
1981	7.02	7.01	6.55	4.57
1980	7.08	7.05	6.50	4.40
1979	6.61	7.02	6.39	4.33
1978	6.71	6.94	6.27	4.53
1977	7.14	7.39	6.63	4.63
1976	7.49	7.31	6.87	4.83

Source: FR Y-9C

Question 6

REVISED
Table 7

Equity plus Loan Loss Reserves as a Percent of Total Assets plus Standby Letters of Credit

Reporting Bank Holding Companies

As of Year End	Asset Size			
	Greater than $150 Million But Less than $300 Million	$300 Million-$1 Billion	Greater than $1 Billion Except 25	Top 25
1986	7.78	7.77	6.90	5.73
1985	7.70	7.52	6.70	5.25
1984	7.34	7.19	6.63	5.13
1983	7.28	7.14	6.63	4.98
1982	7.11	7.00	6.47	4.48
1981	6.95	6.93	6.42	4.30
1980	7.01	6.99	6.41	4.21
1979	6.57	6.98	6.32	4.18
1978	6.69	6.90	6.21	4.39
1977	7.10	7.35	6.58	4.50
1976	7.46	7.27	6.83	4.71

Source: FR Y-9C

Question 6

Table 8

Primary Capital as a Percent of Total Assets

Reporting Bank Holding Companies

As of Year End	Asset Size: Greater than $150 Million But Less than $300 Million	$300 Million-$1 Billion	Greater than $1 Billion Except 25	Top 25
1986	7.97	8.02	7.38	7.11
1985	7.95	7.80	7.22	6.62
1984	7.56	7.40	6.86	5.68
1983	7.55	7.34	6.85	5.42
1982	7.40	7.16	6.67	4.87
1981	7.25	7.08	6.59	4.58

1/ Primary capital includes common stock, perpetual preferred stock, qualifying mandatory convertible debentures, minority interest in unconsolidated subsidiaries, and the allowance for loan and lease losses.

Source: FR Y-9C

Question 6

Table 9

Primary Capital as a Percent of Total Assets plus Standby Letters of Credit

Reporting Bank Holding Companies

As of Year End	Asset Size: Greater than $150 Million But Less than $300 Million	$300 Million-$1 Billion	Greater than $1 Billion Except 25	Top 25
1986	7.91	7.94	7.14	6.45
1985	7.86	7.71	6.98	5.93
1984	7.50	7.31	6.66	5.14
1983	7.47	7.24	6.67	5.00
1982	7.33	7.08	6.51	4.50
1981	7.18	7.00	6.47	4.31

1/ Primary capital includes common stock, perpetual preferred stock, qualifying mandatory convertible debentures, minority interest in unconsolidated subsidiaries, and the allowance for loan and lease losses.

Source: FR Y-9C

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Question 6

Table 10

Selected Capital - Asset Ratios (in percent)

Largest Bank Holding Company's

As of Year End	Ratio 1	Ratio 2	Ratio 3	Ratio 4	Ratio 5	Ratio 6
			Top 10			
1986	6.15%	5.50%	5.34%	7.07%	6.33%	6.15%
1985	5.77%	5.07%	4.97%	6.63%	5.83%	5.71%
1984	5.42%	4.81%	4.73%	5.43%	4.82%	4.74%
1983	5.19%	4.67%	4.58%	5.21%	4.68%	4.60%
1982	4.58%	4.17%	4.22%	4.59%	4.19%	4.23%
1981	4.25%	3.95%	3.97%	4.27%	3.97%	3.99%
			Top 25			
1986	6.32%	5.73%	5.57%	7.11%	6.45%	6.26%
1985	5.86%	5.25%	5.11%	6.62%	5.93%	5.78%
1984	5.67%	5.13%	5.01%	5.68%	5.14%	5.02%
1983	5.40%	4.98%	4.83%	5.42%	5.00%	4.85%
1982	4.85%	4.48%	4.52%	4.87%	4.50%	4.54%
1981	4.57%	4.30%	4.31%	4.58%	4.31%	4.32%

Definitions:

Ratio 1: Equity plus Loan Loss Reserves/Total Assets
Ratio 2: Equity plus Loan Loss Reserves/Total Assets plus Standby Letters of Credit
Ratio 3: Equity plus Loan Loss Reserves/Total Assets plus Adjusted Off-Balance Sheet Items 1/
Ratio 4: Primary Capital/Total Assets
Ratio 5: Primary Capital/Total Assets plus Standby Letters of Credit
Ratio 6: Primary Capital/Total Assets plus Adjusted Off Balance Sheet Item 1/

Note: Adjusted off balance sheet items consist of the following items weighted as indicated: standby letters of credit (80 percent of face value); commercial letters of credit (50 percent of face value); loan commitments (10 percent of face value) and interest rate swaps (5 percent of notional value). See attachment to Table 5 for explanation.

The data on most off-balance sheet activities for bank holding companies is only available for 1986. As a result, the off-balance sheet data for the purpose of this table reflect data aggregated from the subsidiary banks of the bank holding company. In some instances, the data provided by subsidiary banks is also only recently available. The information of loan commitments has been available since 1983; and the data on interest rate swaps has been available since 1985.

Source: Call Reports and FR Y-9 data

Question 7

Table 1

Equity plus Loan Loss Reserves Less Problem Assets as a Percent of Total Assets

Insured Commercial Banks

As of Year End	Asset Size: Less than $300 Million	$300 Million-$1 Billion	Greater than $1 Billion Except Top 25	Top 25
1986	7.71	6.92	6.19	5.00
1985	7.82	7.22	5.19	4.65
1984	7.86	6.85	5.71	4.34
1983	7.86	6.62	5.50	3.97
1982	8.00	6.64	5.52	3.95
1981	8.14	6.87	5.82	4.06
1980	8.16	6.91	5.79	4.01
1979	8.03	6.74	5.93	3.89
1978	7.83	6.69	5.80	3.87

Footnote: Problem assets include 20% of those classified substandard, 50% of doubtful, and 100% of loss.

Source: Examination Records of the FRB, OCC and FDIC and Call Reports.

Question 7

Table 2

Equity plus Loan Loss Reserves Less Problem Assets as a Percent of Total Assets Plus Standby Letters of Credit

Insured Commercial Banks

	Asset Size			
As of Year End	Less than $300 Million	$300 Million-$1 Billion	Greater than $1 Billion Except Top 25	Top 25
1986	7.67	6.81	5.95	4.44
1985	7.77	7.10	5.67	4.08
1984	7.81	6.75	5.51	3.85
1983	7.81	6.53	5.32	3.58
1982	7.96	6.55	5.36	3.62
1981	8.10	6.78	5.70	3.79
1980	8.13	6.84	5.70	3.82
1979	8.01	6.69	5.85	3.74
1978	7.81	6.64	5.73	3.74

Footnote: Problem assets include 20% of those classified substandard, 50% of doubtful, and 100% of loss.

Source: Examination Records of the FRB, OCC, FDIC, and Call Reports.

Question 8

Table 1

Short-Term Assets Less Large Liabilities as a Percent of Total Assets

Insured Commercial Banks

As of Year End	Assets Size: Less than $300 Million	$300 Million-$1 Billion	Greater than $1 Billion Except Top 25	Top 25
1986	8.10	4.18	-7.01	-28.11
1985	5.14	3.22	-8.30	-29.17
1984	4.31	4.56	-6.47	-32.09
1983	14.40	8.31	-4.41	-34.16
1982	11.18	2.93	-7.30	-38.24
1981	10.22	1.46	-9.23	-37.98
1980	11.17	3.12	-7.73	-31.30
1979	10.14	2.51	-7.17	-27.86
1978	10.19	3.76	-4.67	-26.28
1977	14.64	8.96	2.78	-20.04
1976	16.11	9.76	3.75	-18.78

Footnote: Short-term assets for the purpose of this table include: cash and balances due from depository institutions, U.S. Treasury securities, federal funds sold and securities purchased under agreement to resell, loans for purchasing or carrying securities, and assets held in trading accounts. Large liabilities for inclusion in this table include time certificates of deposit of $100,000 or more, open-account time deposits of $100,00 or more, deposits in foreign offices, federal funds purchased and securities sold under agreements to repurchase, demand notes issued to the U.S. Treasury, and other borrowed money.

Source: Call Reports

Question 8

Table 2

Short-Term Assets Less Large Liabilities as a Percent of Total Assets

Reporting Bank Holding Companies

	Asset Size			
As of Year End	Greater than $150 Million But Less than $300 Million	$300 Million-$1 Billion	Greater than $1 Billion Except Top 25	Top 25
1986	10.55	6.05	-2.72	-24.54
1985	8.15	3.88	-3.53	-27.88
1984	8.59	5.15	-1.36	-31.34
1983	9.65	8.45	0.38	-31.93
1982	3.83	3.22	-3.69	-35.82
1981	3.15	0.35	-6.31	-36.57
1980	5.19	2.51	-4.84	-30.13
1979	4.85	3.58	-5.64	-27.29
1978	4.49	4.41	-2.41	-26.30
1977	9.08	8.00	2.54	-22.13
1976	9.34	8.59	3.69	-20.99

Footnote: Short-term assets for the purpose of this table include: cash and balances due from depository institutions, U.S. Treasury securities, federal funds sold and securities purchased under agreements to resell, and assets held in trading accounts. Large liabilities for inclusion in this table include time certificates of deposits of $100,00 or more, deposits in foreign offices, federal funds purchased and securities sold under agreements to repurchase, commercial paper, and other borrowings with an original maturity of one year or less.

Source: FR Y-9C

Question 9

REVISED
Table 1

Purchased Funds as a Percent of Total Assets

Insured Commercial Banks

As of Year End	Assets Class Size: Less than $300 Million	$300 Million-$1 Billion	Greater than $1 Billion Except Top 25	Top 25
1986	12.97	20.81	31.94	52.99
1985	13.73	22.39	34.05	54.86
1984	13.99	22.50	33.84	55.32
1983	13.16	21.37	34.74	58.00
1982	14.94	26.23	38.02	62.53
1981	15.28	26.93	39.50	63.95
1980	13.94	24.64	37.90	61.36
1979	13.27	24.77	35.92	59.80
1978	12.53	23.95	35.72	59.05
1977	10.59	20.64	30.30	54.99
1976	10.33	19.75	29.72	53.96

1 Purchased funds are identical to large liabilities in the prior tables and include time certificates of deposit of $100,000 or more, open-account time deposits of $100,000 or more, deposits in foreign offices, federal funds purchased and securities sold under agreements to repurchase, demand notes issued to the U.S. Treasury, and other borrowed money.

Source: Call Reports

Question 9

Table 2

Purchased Funds As A Percent Of Total Assets

Reporting Bank Holding Companies

As of Year End	Assets Size: $150 Million-$300 Million	$300 Million-$1 Billion	Greater than $1 Billion Except 25	Top 25
1986	13.33	17.42	25.41	45.83
1985	15.36	19.11	27.58	48.76
1984	15.92	19.60	27.58	50.83
1983	16.40	18.66	28.48	53.30
1982	21.39	22.66	32.66	58.28
1981	23.22	24.92	34.84	60.71
1980	20.95	22.34	32.17	58.48
1979	19.11	19.97	32.73	56.86
1978	18.40	19.35	31.33	55.90
1977	14.98	17.55	27.51	53.43
1976	13.91	18.12	26.54	52.58

Footnote: Large liabilities for inclusion in this table include time certificates of deposit of $100,000 or more, open-account time certificates of deposits of $100,000 or more, deposits in foreign offices, federal funds purchased and securities sold under agreements to repurchase, commercial paper, and other borrowings with an original maturity of one year or less.

Source: FR Y-9C

Question 9

Table 3

Brokered Deposits as a Percent of Total Deposits

Insured Commercial Banks

As of Year End	Assets Size: Less than $300 Million	$300 Million-$1 Billion	Greater than $1 Billion Except Top 25	Top 25
1986	0.15	0.88	2.03	1.88
1985	0.12	0.31	2.06	1.66
1984	0.16	0.19	2.41	1.64
1983	0.23	0.23	2.82	1.21

Source: Call Reports

Question 10

Table 1

Net Interest Margin as a Percent of Total Assets

Insured Commercial Banks

As of Year End	Assets Size: Less than $300 Million	$300 Million-$1 Billion	Greater than $1 Billion Except Top 25	Top 25
1986	3.78	3.66	3.26	2.66
1985	3.99	3.71	3.32	2.72
1984	3.90	3.66	3.23	2.62
1983	3.92	3.59	3.03	2.27
1982	4.06	3.67	3.09	2.17
1981	4.03	3.60	2.97	2.00
1980	3.99	3.65	2.91	2.07
1979	3.88	3.55	3.00	2.09
1978	3.69	3.42	2.90	2.13
1977	3.40	3.19	2.81	2.19
1976	3.35	3.24	2.78	2.28

Note: The calculation for net interest margin is not based on average assets and the percentage is not adjusted for tax equivalency — that is interest earned on tax free securities has not been adjusted to reflect that it is not subject to tax as is other interest income.

Source: Call Reports

Question 10

Table 2

Net Interest Margin
As A Percent Of Total Assets

Reporting Bank Holding Companies

As of Year End	Assets Size			
	$150 Million-$300 Million	$300 Million-$1 Billion	Greater than $1 Billion Except 25	Top 25
1986	3.65	3.53	3.26	2.91
1985	3.83	3.63	3.41	3.00
1984	3.61	3.60	3.35	2.80
1983	3.65	3.59	3.32	2.72
1982	3.67	3.66	3.41	2.59
1981	3.66	3.58	3.31	2.33
1980	3.58	3.64	3.12	2.08
1979	3.48	3.66	3.08	2.14
1978	3.40	3.49	3.04	2.12
1977	3.20	3.13	2.83	2.05
1976	3.22	3.17	2.82	2.24

1/ Note: The calculation for net interest margin is not based on average assets and the percentage is not adjusted for tax equivalency — that is interest earned on tax free securities has not been adjusted to reflect that it is not subject to tax as is other interest income.

Source: FR Y-9C

Question 11

Table 1

Net Income as a Percent of Total Assets

Insured Commercial Banks

As of Year End	Assets Size: Less than $300 Million	$300 Million-$1 Billion	Greater than $1 Billion Except Top 25	Top 25
1986	0.59	0.62	0.72	0.51
1985	0.71	0.73	0.78	0.49
1984	0.79	0.84	0.71	0.35
1983	0.87	0.75	0.59	0.48
1982	0.94	0.74	0.65	0.49
1981	1.02	0.82	0.67	0.53
1980	1.07	0.87	0.65	0.55
1979	1.05	0.86	0.72	0.54
1978	0.96	0.81	0.68	0.51
1977	0.89	0.73	0.64	0.47
1976	0.85	0.71	0.62	0.50

Footnote: The data provided on the above table is net income as a percent of year-end total assets.

Source: Call Reports

Question 11

Table 2

Net Income As a Percent of Total Assets

Reporting Bank Holding Companies

As of Year End	Assets Size			
	$150 Million-$300 Million	$300 Million-$1 Billion	Greater than $1 Billion Except 25	Top 25
1986	0.62	0.57	0.60	0.56
1985	0.73	0.63	0.75	0.51
1984	0.70	0.70	0.72	0.38
1983	0.59	0.74	0.70	0.51
1982	0.76	0.69	0.67	0.51
1981	0.79	0.72	0.71	0.52
1980	0.82	0.79	0.70	0.54
1979	0.82	0.84	0.72	0.55
1978	0.77	0.77	0.68	0.52
1977	0.71	0.71	0.67	0.49
1976	0.80	0.69	0.65	0.50

1/ Footnote: The data provided on the above table is net income as a percent of year-end total assets.

Source: FR Y-9C

Question 12

Table 1

Net Income as a Percent of Total Equity

Insured Commercial Banks

As of Year End	Assets Size: Less than $300 Million	$300 Million-$1 Billion	Greater than $1 Billion Except Top 25	Top 25
1986	7.44	9.16	12.14	9.97
1985	8.81	10.33	13.47	9.98
1984	9.78	12.37	12.48	7.19
1983	10.73	11.23	10.49	10.58
1982	11.60	11.01	11.57	11.67
1981	12.51	12.11	11.78	13.05
1980	13.20	12.88	11.58	13.73
1979	13.27	13.08	12.50	13.55
1978	12.44	12.39	11.81	12.34
1977	11.76	11.00	10.79	10.87
1976	11.06	10.53	10.26	11.14

Footnote: The data provided in the above table is net income as a percent of year-end total equity.

Source: Call Reports

Question 12

Table 2

Return On Total Equity

Reporting Bank Holding Companies

As of Year End	Assets Size $150 Million-$300 Million	$300 Million-$1 Billion	Greater than $1 Billion Except 25	Top 25
1986	8.72	8.08	9.75	10.86
1985	10.31	9.17	12.18	10.61
1984	10.43	10.62	11.89	7.97
1983	8.73	11.12	11.51	11.00
1982	11.54	10.63	11.29	12.17
1981	12.27	11.20	12.07	13.06
1980	12.57	12.32	11.92	14.00
1979	13.57	13.13	12.45	14.35
1978	12.52	12.19	12.07	13.04
1977	10.84	10.44	11.04	11.81
1976	11.48	10.18	10.44	11.71

1/ Footnote: The data provided on the above table is net income as a percent of year-end total equity.

Source: FR Y-9C

Question 13

Number of Bank Examiners
and Turnover Rates,
1975 - 1986

Year	Number[1] FRB	FDIC	OCC	Turnover Rate FRB[2]	FDIC[3]	OCC[4]
				(Percent)		
1986	914	1,726	1,812	17.0	9.8	12.4
1985	835	1,547	1,787	14.0	10.7	13.6
1984	820	1,389	1,706	13.0	9.0	15.1
1983	809	1,481	1,818	12.0	6.0	12.0
1982	804	1,551	1,642	12.0	7.1	12.7
1981	800	1,655	1,810	18.0	8.0	15.3
1980	836	1,698	2,037	15.0	8.9	11.7
1979	805	1,713	2,151	18.0	9.4	14.9
1978	744	1,760	2,060	18.0	8.0	15.1
1977	653	1,556	2,157	12.0	10.1	11.7
1976	724	1,644	2,166	12.0	8.2	13.9
1975	644	1,455	2,113	11.0	7.4	8.6

Source: FRB, FDIC, and OCC internal records.

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[1]Numbers approximate field examiners for each agency.

[2]Includes resignations and internal transfers; excludes retirements.

[3]Includes resignations, retirements, and all government agency transfers.

[4]Excludes separations due to deaths, retirements, performance-based resignations, and inter-district reassignments.

Question 14

Table 1
Bank Examiner Man-Hours as a
Percent of Total Bank Deposits,
1975 - 1986

Year	Total Deposits			Examiner Man-Hours[4]			Examiner Man-Hours as % of Total Deposits		
	FRB[1]	FDIC[2]	OCC[3]	FRB[5]	FDIC[6]	OCC	FRB	FDIC	OCC
	($ billions)			(thousands)					
1986	385	830	1,323	1,908	3,602	3,782	.0005	.0004	.0003
1985	353	745	1,242	1,743	3,229	3,729	.0005	.0004	.0003
1984	326	643	1,152	1,711	2,899	3,560	.0005	.0005	.0003
1983	309	600	1,079	1,688	3,091	3,794	.0005	.0005	.0004
1982	304	543	992	1,678	3,237	3,427	.0006	.0006	.0004
1981	287	511	924	1,670	3,454	3,777	.0006	.0007	.0004
1980	275	482	858	1,745	3,544	4,251	.0006	.0007	.0005
1979	266	441	786	1,680	3,575	4,489	.0006	.0008	.0006
1978	240	403	717	1,553	3,673	4,299	.0006	.0009	.0006
1977	218	364	654	1,510	3,431	4,520	.0007	.0009	.0007
1976	199	320	582	1,362	3,247	4,502	.0007	.0010	.0008
1975	187	285	540	1,344	3,037	4,410	.0007	.0011	.0008

Source: FRB, FDIC, and OCC internal records.

1 Data for state member banks only.

2 Data for state nonmember banks and FDIC insured thrifts.

3 Data for national banks only.

4 Estimated by multiplying 2087 annual hours by number of examiners.

5 Represents field examiner time devoted to the examination of state member banks.

6 Represents field examiners only; may also include field examiners who at various times are detailed to the Liquidation Division.

Question 14

Table 2
Alternate Measures of
Federal Reserve Examiner Man-Hours as a
Percent of Total Assets

Year	Total Assets[1] ($ Billions)	Examiner[2] Man-Hours (thousands)	Examiner Man-Hours as % of Total Assets
1986	771	1,832	.0002
1985	712	1,634	.0002
1984	663	1,507	.0002
1983	582	1,430	.0002
1982	558	1,476	.0003
1981	516	1,478	.0003

[1]The total assets figure has been constructed to provide an approximate indication of the dimensions of Federal Reserve examination responsibilities. The figure is derived by summing the total assets of state member banks, the nondepository assets of bank holding companies, and the assets of Edge Act Corporations. The figure does not include assets of trust departments of state member banks which are examined by the Federal Reserve; nor does the figure include the assets of the branches and agencies of foreign banks operating in the U.S. even though the Federal Reserve has residual supervisory responsibilities for these entities.

[2]Examiner man-hours were estimated by calculating the number of Federal Reserve examiners for each of the years, 1981-86, assigned to examine state member banks, parent and nondeposit nonbanking subsidiaries of bank holding companies, foreign subsidiaries of bank holding companies, and Edge Corporations, and multiplying the number of annual man-hours by 2,087, which is the approximation for average annual hours worked per examiner each year.

Distribution of FDIC Insured State-Chartered Savings Banks by Positive/Negative Net Worth

TABLE 1. Including Net Worth Certificates

	0 - $100 Million				$100 - $1,000 Million				Over $1 Billion				Total			
	Positive Net Worth		Negative Net Worth		Positive Net Worth		Negative Net Worth		Positive Net Worth		Negative Net Worth		Positive Net Worth		Negative Net Worth	
	#	Total Assets	#	Total Assets	#	Total Assets	#	Total Assets	#	Total Assets	#	Total Assets	#	Total Assets	#	Total Assets
12-31-86	413	$16,624	0	0	94	$49,346	0	0	38	$98,599	0	0	445	$164,569	0	0
12-31-85	256	$33,513	0	0	75	$39,440	0	0	33	$84,435	0	0	364	$157,387	0	0
12-31-84	168	$23,075	0	0	69	$47,156	0	0	29	$75,249	0	0	266	$135,479	0	0
12-31-83	180	$24,310	0	0	72	$49,110	1	$675	36	$103,485	0	0	288	$176,825	1	$675
12-31-82	201	$24,806	0	0	72	$48,564	0	0	33	$88,478	0	0	306	$151,847	0	0

Dollar amounts are shown in $million.

TABLE 2. Without Net Worth Certificates

	0 - $100 Million				$100 - $1,000 Million				Over $1 Billion				Total			
	Positive Net Worth		Negative Net Worth		Positive Net Worth		Negative Net Worth		Positive Net Worth		Negative Net Worth		Positive Net Worth		Negative Net Worth	
	#	Total Assets	#	Total Assets	#	Total Assets	#	Total Assets	#	Total Assets	#	Total Assets	#	Total Assets	#	Total Assets
12-31-86	413	$16,624	0	0	94	$49,346	0	0	37	$96,268	1	$2,331	444	$162,238	1	$2,331
12-31-85	256	$33,513	0	0	75	$39,440	0	0	33	$78,810	2	$5,625	364	$151,762	2	$5,625
12-31-84	168	$23,075	0	0	68	$36,723	1	$433	26	$64,175	4	$11,074	262	$123,972	4	$11,507
12-31-83	179	$24,237	1	$73	72	$49,110	1	$675	33	$92,648	4	$10,757	284	$155,995	5	$11,505
12-31-82	Calculations Without Net Worth Certificates Not Available for 1982.															

Dollar amounts are shown in $million.

Source: Call Reports.

Question 16

Table 1

Equity Invested in Subsidiaries as a Percent of Total Parent Equity

Reporting Bank Holding Companies

As of Year End	Asset Size			
	Greater than $150 Million But Less than $300 Million	$300 Million-$1 Billion	Greater than $1 Billion Except Top 25	Top 25
1986	108.76	105.77	107.05	125.83
1985	118.83	110.01	115.57	157.26
1984	113.32	109.12	114.01	149.01
1983	112.24	108.24	114.09	145.51
1982	109.55	110.36	113.67	131.84
1981	109.67	111.67	112.84	131.08
1980	116.61	108.23	115.53	131.28
1979	117.89	110.04	115.45	125.10
1978	112.61	113.92	114.88	127.22
1977	103.19	117.51	127.84	126.10
1976	104.07	104.55	116.14	123.94

Footnote: In above table equity invested in subsidiaries includes equity investments plus intangibles in bank as well as non-bank subsidiaries. Total parent equity consists of year-end equity for reporting bank holding company (long parent).

Source: FR Y-9LP

SUPPLEMENTAL TABLES

Supplement

Table A

Net Charge-Offs as a Percent of Year-End Total Assets

Insured Commercial Banks

	Asset Size				
As of Year End	Less Than $300 Million	$300 Million-$1 Billion	Greater Than $1 Billion Except Top 25	Top 25	All Insured Commercial Banks
1986	0.68	0.60	0.50	0.52	0.56
1985	0.61	0.44	0.40	0.48	0.49
1984	0.43	0.33	0.36	0.52	0.43
1983	0.37	0.33	0.37	0.35	0.36
1982	0.33	0.31	0.29	0.28	0.30
1981	0.22	0.20	0.22	0.14	0.19
1980	0.21	0.22	0.25	0.15	0.19
1979	0.16	0.17	0.19	0.12	0.15
1978	0.16	0.18	0.18	0.15	0.16
1977	0.16	0.20	0.22	0.24	0.21
1976	0.21	0.30	0.32	0.35	0.29

1/ Footnote: For the purpose of this table net charge-offs are defined as total charge-offs less total recoveries.

Source: Call Reports.

Supplement

Table B

Provision for Loan Losses as a Percent of Year-End Total Assets

Insured Commercial Banks

As of Year End	Asset Size: Less Than $300 Million	$300 Million-$1 Billion	Greater Than $1 Billion Except Top 25	Top 25	All Insured Commercial Banks
1986	0.81	0.81	0.69	0.72	0.74
1985	0.75	0.61	0.54	0.68	0.65
1984	0.55	0.42	0.47	0.65	0.55
1983	0.45	0.41	0.49	0.45	0.46
1982	0.40	0.40	0.38	0.38	0.39
1981	0.27	0.25	0.29	0.22	0.25
1980	0.25	0.27	0.30	0.20	0.24
1979	0.23	0.24	0.27	0.20	0.22
1978	0.23	0.24	0.27	0.22	0.23
1977	0.20	0.24	0.27	0.26	0.24
1976	0.24	0.31	0.33	0.37	0.31

Source: Call Reports.

Supplement

Table C

Net Charge-Offs as a Percent of Year-End Total Assets

Reporting Bank Holding Companies

	Asset Size				
As of Year End	Greater Than $150 Million But Less Than $300 Million	$300 Million-$1 Billion	Greater Than $1 Billion Except Top 25	Top 25	All Bank Holding Companies
1986	0.54	0.53	0.48	0.63	0.56
1985	0.51	0.46	0.35	0.57	0.47
1984	0.35	0.33	0.29	0.56	0.43
1983	0.39	0.27	0.31	0.38	0.35
1982	0.26	0.29	0.32	0.28	0.30
1981	0.23	0.21	0.24	0.16	0.19

1/ Footnote: For the purpose of this table net charge-offs are defined as total charge-offs less total recoveries.

Source: FR Y-9C

Supplement

Table D

Provision for Loan Losses as a Percent of Year-End Total Assets

Reporting Bank Holding Companies

	Asset Size				
As of Year End	Greater Than $150 Million But Less Than $300 Million	$300 Million-$1 Billion	Greater Than $1 Billion Except Top 25	Top 25	All Bank Holding Companies
1986	0.66	0.69	0.66	0.88	0.77
1985	0.61	0.63	0.47	0.79	0.64
1984	0.43	0.43	0.40	0.69	0.55
1983	0.46	0.34	0.39	0.47	0.43
1982	0.32	0.36	0.42	0.37	0.38
1981	0.27	0.26	0.30	0.24	0.27

Source: FR Y-9C

KENNETH A. MCLEAN, STAFF DIRECTOR
W. CARNEY HALL, MINORITY STAFF DIRECTOR

United States Senate

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
WASHINGTON, DC 20510-6075

May 6, 1987

Hon. Edwin J. Gray
Chairman
Federal Home Loan Bank Board
1700 G Street N.W.
Washington, D.C. 20552

Dear Chairman Gray:

To assist the Senate Committee on Banking, Housing, and Urban Affairs in the exercise of its oversight responsibilities, you are requested to appear before the Committee on May 21, 1987, at 10:00 a.m., in Room 538 of the Dirksen Senate Office Building, to testify on the financial condition of federally insured depository institutions under the jurisdiction of your agency. In your testimony, please provide the Committee with a thorough overview of their current financial condition and respond specifically to the questions below.

1. Are current levels of capital (GAAP and RAP), including consideration of classified assets adequate? How do current capital levels compare with levels in previous years? What is are the current minimum permissible capital levels for FSLIC-insured institutions, and how do they relate to the minimum permissible levels for FDIC-insured institutions?

2. How sensitive is asset quality to regional and national economic conditions? What is the current level of asset quality, and how has it been affected in recent decades by successive periods of recession and recovery? What are present conditions in real estate lending, and how do they compare with those of recent years?

3. What are the current levels of savings and loan earnings with respect both to equity and to total assets, and how do these levels compare with those of years past?

4. How do current liquidity levels, particularly in the form of uninsured and short-term borrowed funds, compare with those of previous years? What has been the impact of the increased use of brokered deposits?

5. What is the present number of so-called "problem institutions"? What is the amount of total deposits held by these institutions? What supervisory actions are being taken in response to the trend in the number of "problem institutions"?

6. How many institutions have had to be liquidated, merged, or assisted to avert failure so far this year? How does this number compare with those in previous years? Do you expect this trend to continue?

7. How many bank examiners does your agency employ? How does this number compare with those of previous years? Do you feel the examiner workforce under your purview is adequate?

In addition to the above information, please provide any other testimony you feel would augment the Committee's understanding of the current financial condition of the institutions under your agency's jurisdiction.

In accordance with Committee Rules, please deliver 100 copies of your prepared statement to Room 534 Dirksen twenty-four hours in advance of your scheduled appearance before the Committee. To provide all Committee Members sufficient time for questioning, the oral presentation of your testimony should be limited to ten minutes.

I look forward to your apppearance before the Committee.

Sincerely,

William Proxmire
Chairman

Federal Home Loan Bank Board

EDWIN J. GRAY
CHAIRMAN

1700 G Street, N.W.
Washington, D.C. 20552
Federal Home Loan Bank System
Federal Home Loan Mortgage Corporation
Federal Savings and Loan Insurance Corporation

May 15, 1987

Honorable William Proxmire
Chairman, Committee on Banking, Housing
and Urban Affairs
United States Senate
Washington, D.C. 20510-6075

Dear Mr. Chairman:

This is in response to your request for statistical information to assist the Senate Banking Committee at its hearings on the "Financial Condition of Federally Insured Depository Institutions".

As requested, the information is provided on an annual basis and is as consistent as possible from year to year. For the most part the information dates back to 1980, not 1970 as requested, since 1980 is the first year in which our records were computerized. Data back to 1980 has been fully acceptable for past submissions to the Committee. Footnotes on each page provide key information with regard to data interpretation. Should your Committee require any additional clarifications or information, please contact this Office. We will be please to assist you insofar as we are able.

Sincerely,

Edwin J. Gray
Chairman

1. (1) Number and total assets [1] of FSLIC-insured institutions.

Year	Institution Size: Small Assets	Small No	Medium Assets	Medium No	Large Assets	Large No	Total Assets	Total No
1986	238,552	2,579	222,160	422	704,579	219	1,165,291	3,220
1985	234,380	2,623	220,927	416	614,659	207	1,069,966	3,246
1984	226,885	2,546	220,037	407	531,592	183	978,514	3,136
1983	218,548	2,664	194,242	372	401,830	147	814,620	3,183
1982	216,686	2,917	157,961	302	311,579	124	686,226	3,343
1981	242,482	3,360	153,040	308	244,412	111	639,934	3,779
1980	253,579	3,615	146,808	293	203,334	94	603,721	4,002
1979	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	568,107	4,039
1978	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	513,310	4,053
1977	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	449,998	4,065
1976	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	383,172	4,044
1975	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	330,259	4,078
1974	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	288,223	4,141
1973	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	264,797	4,163
1972	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	236,349	4,191
1971	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	199,984	4,271
1970	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	170,645	4,365

[1] Assets in millions of dollars.

Definitions

Small - less than $300 million in assets.

Medium - $300 million to $1 billion in assets.

Large - more than $1 billion in assets.

Source

Federal Home Loan Bank Board, Office of Policy and Economic Research.

1. (2) Number and total assets [1] of federally chartered FDIC-insured savings banks.

Year	Institution Size: Small Assets	Small No	Medium Assets	Medium No	Large Assets	Large No	Total Assets	Total No
1986	1,478	10	2,797	5	48,133	12	52,408	27
1985	1,299	10	3,406	6	43,284	12	47,989	28
1984	974	8	3,719	6	38,797	10	43,490	24
1983	1,488	6	2,008	3	33,204	9	36,700	18

There were no federally chartered FDIC-insured savings banks prior to 1983.

[1] Assets in millions of dollars.

Definitions

Small - less than $300 million in assets.

Medium - $300 million to $1 billion in assets.

Large - more than $1 billion in assets.

Source

Federal Home Loan Bank Board, Office of Policy and Economic Research.

2. Number and total assets [1] of institutions failed or absorbed to avert failure.

Institution Size

Year	Small		Medium		Large		Total	
	Assets	No	Assets	No	Assets	No	Assets	No
1986	$ 3,187	39	$ 5,912	12	$5,280	4	$14,379	55
1985	3,983	37	3,256	7	2,495	1	9,734	45
1984	2,446	31	3,503	5	---	--	5,949	36
1983	4,470	67	2,798	6	---	--	7,268	73
1982	16,579	226	11,712	22	9,076	7	37,367	255
1981	4,533	72	4,058	7	6,530	3	15,121	82
1980	2,078	30	743	2	---	--	2,821	32

Total number of institutions includes (a) supervisory mergers arranged by FHLBs, (b) FSLIC-assisted mergers and (K) thrift institutions liquidated by the FSLIC.

[1] Assets in millions of dollars.

Definitions

Institutions include all FSLIC-insured institutions and federally chartered FDIC-insured savings banks.

Small - less than $300 million in assets.

Medium - $300 million to $1 billion in assets.

Large - more than $1 billion in assets.

Source

Federal Home Loan Bank Board, FSLIC.

3. Number and total assets [1] of troubled institutions.

Year	Institution Size: Small Assets	Small No	Medium Assets	Medium No	Large Assets	Large No	Total Assets	Total No
1986	$51,567	472	$59,626	110	$141,268	51	$252,461	633
1985	53,091	504	65,311	121	118,104	44	236,506	669
1984	56,085	544	76,882	141	147,419	53	280,386	738
1983	50,157	532	53,237	104	98,290	42	201,684	678
1982	50,510	581	49,512	93	101,230	46	201,252	720
1981	35,637	427	30,602	63	40,462	23	106,701	513
1980	10,856	142	6,472	12	7,953	5	25,281	159

[1] Assets in millions of dollars.

Definitions

Institutions include all FSLIC-insured institutions and federally chartered FDIC-insured savings banks.

Small - less than $300 million in assets.

Medium - $300 million to $1 billion in assets.

Large - more than $1 billion in assets.

Troubled institutions - Institutions with MACRO rating of "4" or "5" as of year end.

Source

ETWRS - Examination Tracking and Workload Reporting System for the FHLBB.

4. Nonperforming loans and leases as a percent of total assets.

Institution Size

Year	Small	Medium	Large	Total
1986	0.93%	0.89%	0.52%	0.67%
1985	0.66%	0.56%	0.42%	0.50%
1984	0.43%	0.35%	0.26%	0.32%
1983	0.37%	0.31%	0.28%	0.31%
1982	0.34%	0.30%	0.28%	0.31%
1981	0.24%	0.22%	0.19%	0.22%
1980	0.20%	0.16%	0.12%	0.17%
1979	0.16%	0.15%	0.10%	0.14%

Definitions

Institutions include all FSLIC-insured institutions and federally chartered FDIC-insured savings banks.

Small - less than $300 million in assets.

Medium - $300 million to $1 billion in assets.

Large - more than $1 billion in assets.

Nonperforming Loans and Leases - 20.0 percent of scheduled items, the latter as defined in section 561.15 of the rules and regulations for the FSLIC. Nonperforming assets are included in the definition of scheduled items.

Sources

1979 - 1983 - Semiannual FHLBB report data.
1984 - 1986 - Quarterly FHLBB report data.

5. Problem assets as a percent of total assets.

Institution Size

Year	Small	Medium	Large	Total
1986	0.53%	0.50%	0.27%	0.36%

Definitions

Institutions include all FSLIC-insured institutions and federally chartered FDIC-insured savings banks.

Small - less than $300 million in assets.

Medium - $300 million to $1 billion in assets.

Large - more than $1 billion in assets.

Problem Assets - 20 percent of substandard assets, 50 percent of doubtful assets and 100 percent of loss assets as defined in Section 561.16c of the Rules and Regulations for the FSLIC. Data for classification of assets was not individually collected prior to 1986.

Source

Quarterly FHLBB report data.

6. (1) Primary capital of federally insured institutions as a percent of total assets.

	Institution Size			
Year	Small	Medium	Large	Total
1986	3.81%	3.28%	4.23%	3.97%
1985	4.06%	3.46%	3.76%	3.76%
1984	3.99%	3.34%	3.22%	3.41%
1983	4.02%	3.50%	3.62%	3.70%
1982	4.22%	3.25%	3.11%	3.48%
1981	4.92%	4.03%	3.99%	4.34%
1980	5.78%	5.03%	5.08%	5.36%
1979	5.96%	5.45%	5.52%	5.70%

Definitions

Institutions include all FSLIC-insured institutions and federally chartered FDIC-insured savings banks.

Small - less than $300 million in assets.

Medium - $300 million to $1 billion in assets.

Large - more than $1 billion in assets.

Primary Capital - Net worth minus qualifying mutual capital certificates, qualifying subordinated debentures, appraised equity capital, net worth certificates, accrued net worth certificates and income capital certificates.

Sources

1979 - 1980 - Semiannual FHLBB report data.
1984 - 1986 - Quarterly FHLBB report data.

6. (2) Primary capital of federally insured institutions as a percent of total assets plus off-balance sheet obligations.

Institution Size

Year	Small	Medium	Large	Total
1986	3.76%	3.23%	4.13%	3.89%
1985	4.01%	3.40%	3.66%	3.69%
*1984	3.98%	3.33%	3.19%	3.40%

* Data for 1984 includes only letters of credit issued and outstanding.

Definitions

Institutions include all FSLIC-insured institutions and federally chartered FDIC-insured savings banks.

Small - less than $300 million in assets.

Medium - $300 million to $1 billion in assets.

Large - more than $1 billion in assets.

Primary Capital - Net worth minus qualifying mutual capital certificates, qualifying subordinated debentures, appraised equity capital, net worth certificates, accrued net worth certificates and income capital certificates.

Off-Balance Sheet Obligations - Letters of credit issued and outstanding, underlying notional principal of interest rate swaps in effect and principal amount of loans sold with recourse. The Bank Board did not collect data relative to separate statistics on off-balance sheet obligations prior to 1984.

Sources

1979 - 1980 - Semiannual FHLBB report data.
1984 - 1986 - Quarterly FHLBB report data.

7. (1) Primary capital less problem assets as a percent of total assets.

Institution Size

Year	Small	Medium	Large	Total
1986	3.27%	2.78%	3.96%	3.61%

Definitions

Institutions include all FSLIC-insured institutions and federally chartered FDIC-insured savings banks.

Small - less than $300 million in assets.

Medium - $300 million to $1 billion in assets.

Large - more than $1 billion in assets.

Primary Capital - Net worth minus qualifying mutual capital certificates, qualifying subordinated debentures, appraised equity capital, net worth certificates, accrued net worth certificates and income capital certificates.

Problem Assets - 20 percent of substandard assets, 50 percent of doubtful assets and 100 percent of loss assets as defined in Section 561.16c of the Rules and Regulations for the FSLIC. Data for classification of assets was not individually collected prior to 1986.

Source

Quarterly FHLBB report data.

7. (1) Primary capital less classified assets as a percent of total assets.

Institution Size

Year	Small	Medium	Large	Total
1986	2.88%	2.40%	3.72%	3.31%
1985	3.40%	2.90%	3.33%	3.26%
1984	3.55%	2.99%	2.94%	3.09%
1983	3.66%	3.10%	2.99%	3.39%
1982	3.87%	2.94%	2.82%	3.18%
1981	4.67%	3.81%	3.79%	4.13%
1980	5.57%	4.86%	4.95%	5.20%
1979	5.80%	5.30%	5.42%	5.56%

Definitions

Institutions include all FSLIC-insured institutions and federally chartered FDIC-insured savings banks.

Small - less than $300 million in assets.

Medium - $300 million to $1 billion in assets.

Large - more than $1 billion in assets.

Primary Capital - Net worth minus qualifying mutual capital certificates, qualifying subordinated debentures, appraised equity capital, net worth certificates, accrued net worth certificates and income capital certificates.

Classified Assets - 20 percent of scheduled items, the latter as defined in Section 561.15 of the Rules and Regulations for the FSLIC.

Sources

1979 - 1980 - Semiannual FHLBB report data.
1984 - 1986 - Quarterly FHLBB report data.

This table is an update of the prior table submitted in the 1985 response.

7. (2) Primary capital less problem assets as a percent of total assets plus off-balance sheet obligations.

Institution Size

Year	Small	Medium	Large	Total
1986	3.23%	2.73%	3.87%	3.54%

Definitions

Institutions include all FSLIC-insured institutions and federally chartered FDIC-insured savings banks.

Small - less than $300 million in assets.

Medium - $300 million to $1 billion in assets.

Large - more than $1 billion in assets.

Primary Capital - Net worth minus qualifying mutual capital certificates, qualifying subordinated debentures, appraised equity capital, net worth certificates, accrued net worth certificates and income capital certificates.

Problem Assets - 20 percent of substandard assets, 50 percent of doubtful assets and 100 percent of loss assets as defined in Section 561.16c of the Rules and Regulations for the FSLIC. Data for Classification of assets was not individually collected prior to 1986.

Off-Balance Sheet Obligations - Letters of credit issued and outstanding, underlying notional principal of interest rate swaps in effect and principal amount of loans sold with recourse.

Source

Quarterly FHLBB report data.

7. (2) Primary capital less classified assets as a percent of total assets plus off-balance sheet obligations.

Institution Size

Year	Small	Medium	Large	Total
1986	2.84%	2.36%	3.63%	3.24%
1985	3.36%	2.85%	3.25%	3.19%
*1984	3.55%	2.98%	2.93%	3.08%

* Data for 1984 includes only letters of credit issued and outstanding.

Definitions

Institutions include all FSLIC-insured institutions and federally chartered FDIC-insured savings banks.

Small - less than $300 million in assets.

Medium - $300 million to $1 billion in assets.

Large - more than $1 billion in assets.

Primary Capital - Net worth minus qualifying mutual capital certificates, qualifying subordinated debentures, appraised equity capital, net worth certificates, accrued net worth certificates and income capital certificates.

Classified Assets - 20 percent of scheduled items, the latter as defined in Section 561.15 of the Rules and Regulations for the FSLIC.

Off-Balance Sheet Obligations - Letters of credit issued and outstanding, underlying notional principal of interest rate swaps in effect and principal amount of loans sold with recourse. The Bank Board did not collect data relative to separate statistics on off-balance sheet obligations prior to 1984.

Sources

1979 - 1980 - Semiannual FHLBB report data.
1984 - 1986 - Quarterly FHLBB report data.

This table defines "classified assets" as submitted in the 1985 response.

8. Short-term assets less large liabilities as a percent of total assets.

Institution Size

Year	Small	Medium	Large	Total
1986	7.84%	4.07%	-3.28%	0.26%
1985	7.06%	3.41%	-3.60%	0.05%
1984	5.82%	1.22%	-4.09%	-0.72%
1983	12.50%	13.36%	9.15%	11.05%
1982	10.29%	12.04%	9.14%	10.17%
1981	7.46%	6.79%	1.45%	5.00%
1980	7.94%	6.77%	1.74%	5.57%
1979	2.94%	2.36%	-4.94%	0.42%

Definitions

Institutions include all FSLIC-insured institutions and federally chartered FDIC-insured savings banks.

Small - less than $300 million in assets.

Medium - $300 million to $1 billion in assets.

Large - more than $1 billion in assets.

Short-term Assets - Total assets eligible for regulatory liquidity as defined in Section 523.10(g) of the Rules and Regulations for the FSLIC.

Large Liabilities - Deposits and certificate accounts with balances in excess of $100,000 for the years 1984 through 1986; with balances of $100,000 or more for the years 1979 through 1983.

Sources

1979 - 1980 - Semiannual FHLBB report data.
1984 - 1986 - Quarterly FHLBB report data.

9. Purchased funds and brokered deposits as a percent of total assets.

Institution Size

Year	Small	Medium	Large	Total
1986	2.23%	5.44%	17.13%	12.06%
1985	2.45%	5.21%	15.33%	10.59%
1984	3.62%	8.53%	14.84%	10.97%
1983	4.53%	7.12%	11.74%	8.71%
1982	3.44%	5.13%	8.52%	6.13%
1981	2.00%	4.19%	7.52%	4.63%
1980	1.17%	3.28%	6.35%	3.43%
1979	1.30%	2.44%	5.86%	2.96%

Definitions

Institutions include all FSLIC-insured institutions and federally chartered FDIC-insured savings banks.

Small - less than $300 million in assets.

Medium - $300 million to $1 billion in assets.

Large - more than $1 billion in assets.

Purchased Funds - Defined as borrowings from all sources other than a FHLBank. For 1980 through 1986, borrowings include commercial bank loans, reverse repurchase agreements, consumer retail repurchase agreements, overdrafts in demand deposits, commercial paper issued, subordinated debentures nonqualifying for net worth and mortgage-backed bonds issued. Prior to 1980, borrowings include all the above items except overdrafts in demand deposits and commercial paper issued; the Bank Board did not collect data for these specific items.

Sources

1979 - 1980 - Semiannual FHLBB report data.
1984 - 1986 - Quarterly FHLBB report data.

10. Net interest margin as a percent of average earning assets.

Institution Size

Year	Small	Medium	Large	Total
1986	1.94%	1.64%	1.56%	1.65%
1985	1.79%	1.43%	1.30%	1.43%
1984	1.29%	1.06%	0.73%	0.94%
1983	1.02%	0.93%	0.76%	0.87%
1982	-0.18%	-0.44%	-0.71%	-0.48%
1981	0.08%	-0.31%	-0.56%	-0.26%
1980	1.14%	0.89%	0.81%	0.97%

Definitions

Institutions include all FSLIC-insured institutions and federally chartered FDIC-insured savings banks.

Small - less than $300 million in assets.

Medium - $300 million to $1 billion in assets.

Large - more than $1 billion in assets.

Earning Assets - Net mortgage loans and contract, net nonmortgage loans and contracts, net real estate held for development/investment/resale and net cash, deposits and investment securities.

Sources

1980 - 1983 - Semiannual FHLBB report data.
1984 - 1986 - Quarterly FHLBB report data.

11. Return on total assets.

Year	Institution Size			
	Small	Medium	Large	Total
1986	-0.01%	-0.41%	0.37%	0.15%
1985	0.26%	0.18%	0.50%	0.38%
1984	0.20%	0.22%	0.04%	0.12%
1983	0.16%	0.32%	0.28%	0.26%
1982	-0.72%	-0.66%	-0.54%	-0.62%
1981	-0.71%	-0.83%	-0.73%	-0.75%
1980	0.14%	0.07%	0.17%	0.13%
1979	n.a.	n.a.	n.a.	0.67%
1978	n.a.	n.a.	n.a.	0.82%
1977	n.a.	n.a.	n.a.	0.77%
1976	n.a.	n.a.	n.a.	0.63%
1975	n.a.	n.a.	n.a.	0.47%
1974	n.a.	n.a.	n.a.	0.54%
1973	n.a.	n.a.	n.a.	0.76%
1972	n.a.	n.a.	n.a.	0.77%
1971	n.a.	n.a.	n.a.	0.71%
1970	n.a.	n.a.	n.a.	0.57%

Definitions

Institutions include all FSLIC-insured institutions and federally chartered FDIC-insured savings banks.

Small - less than $300 million in assets.

Medium - $300 million to $1 billion in assets.

Large - more than $1 billion in assets.

Return on assets - Net after-tax income as a percent of average assets.

n.a. - Not available.

Source

Federal Home Loan Bank Board, Office of Policy and Economic Research

12. Net income as a percent of equity capital.

Institution Size

Year	Small	Medium	Large	Total
1986	-0.40%	-16.89%	9.75%	4.38%
1985	8.96%	7.65%	15.25%	12.80%
1984	6.47%	8.78%	1.36%	4.00%
1983	4.56%	12.79%	9.23%	8.50%
1982	-16.52%	-21.37%	-16.58%	-17.52%
1981	-13.36%	-18.66%	-16.33%	-15.60%
1980	2.39%	1.42%	3.27%	2.45%
1979	n.a.	n.a.	n.a.	12.12%
1978	n.a.	n.a.	n.a.	14.91%
1977	n.a.	n.a.	n.a.	14.00%
1976	n.a.	n.a.	n.a.	11.15%
1975	n.a.	n.a.	n.a.	7.84%
1974	n.a.	n.a.	n.a.	8.67%
1973	n.a.	n.a.	n.a.	12.21%
1972	n.a.	n.a.	n.a.	12.20%
1971	n.a.	n.a.	n.a.	10.55%
1970	n.a.	n.a.	n.a.	7.99%

Definitions

Institutions include all FSLIC-insured institutions and federally chartered FDIC-insured saving banks.

Small - less than $300 million in assets.

Medium - $300 million to $1 billion in assets.

Large - more than $1 billion in assets.

Net Income - Net income after taxes.

Equity Capital - Regulatory capital less items not permitted by GAAP.

n.a. - Not available.

Source

Federal Home Loan Bank Board, Office of Policy and Economic Research.

13. Number of examiners and their turnover ratio for each of the supervisory agencies.

	Date	Actual Full Time Equivalent Examination Staff [1]	Turnover Ratio
	9/30/86	1519 [2]	16.0% [4]
	12/31/85	1095 [2]	15.6% [3]
	7/06/85	856 [2]	n.a.
	6/22/84	849 [2]	n.a.
FYE	9/30/83	891	n.a.
FYE	9/30/82	917	n.a.
FYE	9/30/81	908	n.a.
FYE	9/30/80	878	n.a.

Definitions

FYE - Fiscal Year End

On July 6, 1985, the entire examination staff was transferred under the control of the 12 Federal Home Loan Banks.

Sources: FHLBB Budget Division.

Federal Home Loan Banks' Report Examination and Supervisory Activities January 1 Through September 30, 1986, Office of Regulatory Policy Oversight and Supervision, December 12, 1986.

Federal Home Loan Banks' Report 1985, Office of Examinations and Supervision, July 9, 1986.

[1] Includes total field examination employment and, in addition to examiners, includes district directors and other examination field offices' overhead personnel. Percent of examiners to total field employment is approximately 84%.

[2] Represents actual number (count) of field examination employment at that date.

[3] For period 7/6/85 to 12/31/85 annualized.
Equals resignations divided by average staff size.

[4] For period 1/1/86 to 9/30/86 annualized.
Equals resignations divided by average staff size.

14. Number of examiner manhours per million dollars of total deposits.

Actual Full Time Equivalent Examination Staff	Date	Total Deposits [1]	Date of Deposits	Manhours [2] Deposits
1519	9/30/86	922,751	9/30/86	3.42
1095	12/31/85	883,726	12/31/85	2.58
856	7/06/85	857,426	6/30/85	2.08
849	6/22/84	764,431	6/30/84	2.31
891	9/30/83	667,268	9/30/83	2.78
917	9/30/82	549,957	9/30/82	3.47
908	9/30/81	512,269	9/30/81	3.69
878	9/30/80	459,033	9/30/80	3.98

[1] Deposits in millions. Total deposits as of the next available semiannual or quarterly reporting period except for 7/06/85 where 6/30/85 deposit data was used.

[2] Examiner manhours is calculated assuming the examination staff works 40 hours per week, 52 weeks per year.

Sources: FHLBB Budget Division.

Federal Home Loan Banks' Report Examination and Supervisory Activities January 1 Through September 30, 1986, Office of Regulatory Policy Oversight and Supervision, December 12, 1986.

Federal Home Loan Banks' Report 1985, Office of Examinations and Supervision, July 9, 1986.

1980 - 1983 - Semiannual FHLBB report data.
1984 - 1986 - Quarterly FHLBB report data.

15. (1) Number and total assets [1] of institutions with positive net worth.

Year	Institution Size: Small Assets	Small No	Medium Assets	Medium No	Large Assets	Large No	Total Assets	Total No
1986	218,124	2,390	205,551	390	727,379	215	1,151,054	2,995
1985	224,292	2,523	216,722	405	651,253	215	1,092,267	3,143
1984	223,009	2494	219,159	404	565,032	191	1,007,200	3,089
1983	216,692	2,624	193,899	370	428,115	153	838,706	3,147
1982	212,148	2,847	154,283	295	306,738	121	673,169	3,263
1981	240,412	3,323	151,704	306	240,627	109	632,743	3,738
1980	253,452	3,598	146,808	293	203,334	94	603,594	3,985
1979	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	567,977	4,026
1978	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	513,136	4,057
1977	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	449,927	4,057
1976	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	383,068	4,033
1975	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	330,177	4,061

[1] Assets in millions of dollars.

Definitions

Institutions include all FSLIC-insured institutions and federally chartered FDIC-insured saving banks.

Small - less than $300 million in assets.

Medium - $300 million to $1 billion in assets.

Large - more than $1 billion in assets.

Net Worth - Net worth as calculated according to regulatory accounting principles.

Source

Federal Home Loan Bank Board, Office of Policy and Economic Research.

15. (2) Number and total assets [1] of institutions with negative net worth.

Year	Institution Size: Small Assets	Small No	Medium Assets	Medium No	Large Assets	Large No	Total Assets	Total No
1986	21,906	199	19,406	37	25,333	16	66,645	252
1985	11,387	110	7,611	17	6,690	4	25,688	131
1984	4,850	60	4,597	9	5,357	2	14,804	71
1983	3,344	46	2,351	5	6,919	3	12,614	54
1982	4,538	70	3,678	7	4,841	3	13,057	80
1981	2,070	37	1,336	2	3,785	2	7,191	41
1980	127	17	0	0	0	0	127	17
1979	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	130	13
1978	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	174	7
1977	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	71	8
1976	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	104	11
1975	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	82	17

[1] Assets in millions of dollars.

Definitions

Institutions include all FSLIC-insured institutions and federally chartered FDIC-insured saving banks.

Small - less than $300 million in assets.

Medium - $300 million to $1 billion in assets.

Large - more than $1 billion in assets.

Net Worth - Net worth as calculated according to regulatory accounting principles.

Source

Federal Home Loan Bank Board, Office of Policy and Economic Research.

16. For bank and thrift holding companies, equity invested in subsidiaries as a percent of total bank equity (double leveraging ratio).

This information is not provided since the Bank Board does not collect data relative to thrift holding companies.

17. Income taxes paid as a percent of net income.

	Institution Size			
Year	Small	Medium	Large	Total
1986	103.6%	-154.9%**	42.4%	65.5%
1985	47.3%	49.1%	28.9%	34.6%
1984	37.3%	33.7%	59.5%	42.1%
1983	33.3%	18.5%	21.4%	22.9%
1982	20.6%	27.4%	33.3%	27.6%
*1981	17.6%	23.7%	31.2%	24.7%
*1980	34.8%	36.7%	32.7%	34.2%
1979	n.a.	n.a.	n.a.	30.4%
1978	n.a.	n.a.	n.a.	31.5%
1977	n.a.	n.a.	n.a.	30.6%
1976	n.a.	n.a.	n.a.	30.1%
1975	n.a.	n.a.	n.a.	30.5%
1974	n.a.	n.a.	n.a.	30.8%
1973	n.a.	n.a.	n.a.	28.5%
1972	n.a.	n.a.	n.a.	27.2%
1971	n.a.	n.a.	n.a.	24.8%
1970	n.a.	n.a.	n.a.	20.0%

* Both income taxes and income were negative in 1981 and 1983. Ratios for some later years are distorted by the large losses experienced by a small number of firms.

** Pretax net income was negative.

Definitions

Institutions include all FSLIC-insured institutions and federally chartered FDIC-insured savings banks.

Small - less than $300 million in assets.

Medium - $300 million to $1 billion in assets.

Large - $1 billion in assets or more.

Net Income - Income before income taxes.

n.a. - Not available.

Source

Federal Home Loan Bank Board, Office of Policy and Economic Research.

WILLIAM PROXMIRE, WISCONSIN, CHAIRMAN

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United States Senate

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
WASHINGTON, DC 20510-6075

May 6, 1987

Hon. Roger W. Jepsen
Chairman
National Credit Union Administration
1776 G Street N.W.
Washington, D.C. 20551

Dear Chairman Jepsen:

To assist the Senate Committee on Banking, Housing, and Urban Affairs in the exercise of its oversight responsibilities, you are requested to appear before the Committee on May 21, 1987, at 10:00 a.m., in Room 538 of the Dirksen Senate Office Building, to testify on the financial condition of federally insured depository institutions under the jurisdiction of your agency. In your testimony, please provide the Committee with a thorough overview of their current financial condition and respond specifically to the questions below.

1. Are current levels of capital, including consideration of classified assets adequate? How do current capital levels compare with levels in previous years?

2. How sensitive is asset quality to regional or national economic conditions? What is the current level of asset quality, and how has it been affected in recent decades by successive periods of recession and recovery and in recent years by the growth in credit union deposits?

3. What are the current levels of credit union earnings, and how do these levels compare with those of years past?

4. How do current liquidity levels, particularly in the form of uninsured and short-term borrowed funds, compare with those of previous years? What has been the impact of the increased use of brokered deposits?

5. What is the present number of so-called "problem institutions"? What is the amount of total share accounts held by these institutions? What supervisory actions are being taken in response to the trend in the number of "problem institutions"?

6. How many institutions have had to be liquidated, merged, or assisted to avert failure so far this year? How does this number compare with those in previous years? Do you expect this trend to continue?

7. How many examiners does your agency employ? How does this number compare with those of previous years? Do you feel the examiner workforce under your purview is adequate?

In addition to the above information, please provide any other testimony you feel would augment the Committee's understanding of the current financial condition of institutions under your agency's jurisdiction.

In accordance with Committee Rules, please deliver 100 copies of your prepared statement to Room 534 Dirksen twenty-four hours in advance of your scheduled appearance before the Committee. To provide all Committee Members sufficient time for questioning, the oral presentation of your testimony should be limited to ten minutes.

I look forward to your apppearance before the Committee.

Sincerely,

William Proxmire
Chairman

NATIONAL CREDIT UNION ADMINISTRATION
WASHINGTON, D.C. 20456

(1)

May 15, 1987

OFFICE OF THE CHAIRMAN

Honorable William Proxmire
Chairman
Committee on Banking, Housing, and
Urban Affairs
United States Senate
Washington, DC 20510-6075

Dear ~~Senator Proxmire~~ Bill:

The attached information on credit union operations is submitted in response to your request of April 8.

Our information is as complete as possible. However, you should be aware that certain statistics for the years prior to 1979 are not available. For each item, we have carried the data back to either 1971, the year NCUA began operations, or to the earliest date for which we have information.

I also want to take this opportunity to thank you for your outstanding work in securing Senate passage of S. 790. Title V of that bill, as you know, would restore and make permanent NCUA's vital conservatorship authority. The Agency has been without this essential authority since last October, and its swift restoration is of utmost importance.

With kindest personal regards, I am

Sincerely,

ROGER W. JEPSEN
Chairman

RWJ:cch

ITEM #1

TOTAL NUMBER, ASSETS, DEPOSITS (SHARES), AND MEMBERS
OF ALL FEDERALLY INSURED CREDIT UNIONS

Year	Number of Credit Unions	Number of Members	Assets (Millions)	Shares (Millions)
1986	14,693	48,408,259	$147,728	$136,051
1985	15,045	45,265,122	$119,730	$109,533
1984	15,193	43,356,240	$92,846	$84,254
1983	15,877	41,076,615	$81,961	$74,186
1982	16,435	39,298,832	$69,572	$62,976
1981	16,963	38,413,265	$64,490	$57,796
1980	17,350	36,856,813	$60,962	$54,732
1979	17,507	37,008,329	$54,925	$47,703
1978	17,121	34,739,247	$51,417	$44,119
1977	16,632	29,421,785	$43,451	$37,333
1976	16,276	26,297,210	$35,095	$30,354
1975	15,777	23,747,455	$28,814	$24,973
1974	15,146	21,068,652	$22,754	$19,562
1973	14,344	18,496,398	$18,902	$16,332
1972	14,023	16,615,768	$15,811	$13,843
1971	13,510	14,626,44[illegible]	$12,508	$10,891

NOTE: All data throughout the report is combined for federally chartered credit unions and for federally insured state-chartered credit unions.

ITEM #2

NUMBER AND TOTAL DEPOSITS (SHARES)OF ORGANIZATIONS
FAILED OR ABSORBED TO AVERT FAILURE

Year	Liquidations		Assisted Mergers/ Purchase & Assumptions	
	Number	Amount of Shares (Millions)	Number	Amount of Shares (Millions)
1986	35	$22.1	62	$81.7
1985	31	$15.5	71	$62.5
1984	38	$34.8	100	$190.2
1983	50	$10.0	212	N/A
1982	160	$39.9	182	N/A
1981	251	$78.6	100	N/A
1980	239	$60.0	63	N/A
1979	169	$19.0		
1978	168	$14.2		
1977	142	$12.7		
1976	128	$7.5		
1975	153	$5.5		
1974	100	$2.8		
1973	50	$1.4		
1972	4	$0.002		
1971	0	$0		

Numbers of assisted mergers and purchase and assumptions were not identified separately from unassisted mergers until 1980.

The above data is reported as of fiscal year-end - September 30.

ITEM #3

NUMBER AND TOTAL DEPOSITS (SHARES) OF "PROBLEM" ORGANIZATIONS

Year	Number	Deposits (Millions)
1986	794	$6,611
1985	742	$4,055
1984	872	$4,071
1983	1,124	$4,652
1982	1,192	$4,590
1981	1,174	$2,980
1980	1,018	$2,400
1979	1,020	$2,300
1978	825	$1,450
1977	660	$531
1976	830	$570

"Problem" organizations are defined as codes 4 and 5 federal credit unions and federally insured state-chartered credit unions.

The above data is reported as of fiscal year-end - September 30.

NOTE: The National Credit Union Administration currently uses an Early Warning System code which is comparable to CAMEL ratings.

ITEM #4

NONPERFORMING LOANS AND LEASES AS A PERCENTAGE OF TOTAL ASSETS

Year	Percentage
1986	.53
1985	.56
1984	.61
1983	.74
1982	.93
1981	.91
1980	1.03
1979	.96
1978	.77

For purposes of this report, nonperforming assets are considered to be all loans in excess of 6 months delinquent.

ITEM #5

PROBLEM ASSETS AS A PERCENT OF TOTAL ASSETS

Year	Percentage
1986	.32
1985	.34
1984	.38
1983	.46
1982	.58
1981	.74
1980	.77
1979	.70
1978	.56

Problem assets are defined as 50 percent of loans 6 to 12 months delinquent and 75 percent of loans in excess of 12 months delinquent. Loan delinquency by age category is not available prior to 1978.

ITEM #6

PRIMARY CAPITAL AS A
PERCENTAGE OF TOTAL ASSETS
(PART 1)

Year	Percentage
1986	6.65
1985	6.90
1984	7.07
1983	6.86
1982	7.24
1981	6.98
1980	6.40
1979	6.66
1978	6.25
1977	6.05
1976	6.30
1975	6.56
1974	7.00
1973	8.96
1972	9.23
1971	9.66

As nonprofit cooperatives, credit unions do not have "capital." However, for purposes of this report and in order to be somewhat consistent with the reporting of the other agencies, capital in credit unions is defined as all reserves and retained earnings and does not include shares.

ITEM #6

PRIMARY CAPITAL AS A PERCENT OF TOTAL ASSETS
PLUS OFF-BALANCE SHEET OBLIGATIONS
(PART 2)

The figures for this item would be the same as Item #6, Part 1. Credit unions do not have standby letters of credit or other significant off-balance sheet items.

ITEM #7

PRIMARY CAPITAL LESS PROBLEM ASSETS AS A PERCENTAGE OF TOTAL ASSETS
(PART 1)

Year	Percentage
1986	6.33
1985	6.56
1984	6.68
1983	6.39
1982	6.66
1981	6.40
1980	5.76
1979	6.06
1978	5.78

See the definition of primary capital under Item #6, Part 1. See definition of problem assets under Item #5.

ITEM #7

PRIMARY CAPITAL LESS PROBLEM ASSETS AS A PERCENTAGE OF TOTAL ASSETS, INCLUDING STANDBY LETTERS OF CREDIT AND OTHER OFF-BALANCE SHEET ITEMS
(PART 2)

The figures for this item would be the same as Item #7, Part 1. Credit unions do not have standby letters of credit or other significant off-balance sheet items.

ITEM #8

SHORT-TERM ASSETS LESS LARGE LIABILITIES AS A PERCENTAGE OF TOTAL ASSETS

Year	Percentage
1986 *	27.64
1985	24.57
1984	21.38
1983	27.23
1982	27.54
1981	18.39
1980	16.62
1979	3.89

For the purpose of this report, short-term assets are defined as cash and all investments with remaining maturities of 1 year or less. Large liabilities are defined as deposits/share accounts of $100,000 or more, notes and interest on notes payable and reverse repurchase agreements.

NOTE: Prior to 1980, accounts were insured for amounts up to $40,000. From 1980 forward, accounts were all insured up to $100,000. Data is not available prior to 1979.

* Partially estimated.

ITEM #9

PURCHASED FUNDS AND BROKERED DEPOSITS,
EACH AS A PERCENTAGE OF TOTAL ASSETS

Year	Percentage
1986	.4
1985	.6
1984	1.0
1983	.8
1982	.9
1981	1.9
1980	2.3
1979	4.8
1978	6.2
1977	5.3
1976	4.3
1975	3.9
1974	4.1
1973	3.7
1972	2.3
1971	2.3

The percentages listed above represent borrowed funds. There have been some isolated incidents of brokered funds received by credit unions, but this does not seem to be a widespread occurence. Brokered funds activity was reported by credit unions for the first time on the December 1984 call reports, but the information was subsequently found to be inaccurate - overstated. The data reported would have resulted in a figure of less than .1 percent.

ITEM #10

NET INTEREST MARGIN AS A PERCENTAGE OF TOTAL ASSETS

Year	Percentage
1986	4.06
1985	4.36
1984	4.73
1983	4.54
1982	4.85
1981	4.98
1980	4.07
1979	4.24
1978	3.93
1977	3.91
1976	4.05
1975	3.98
1974	4.30
1973	4.13
1972	4.16
1971	4.25

For the purposes of this report, the net income margin is defined as gross income less interest on borrowed money and interest on deposits/dividends on shares.

ITEM #11

RETURN ON TOTAL ASSETS

Year	Percentage
1986	.10
1985	.10
1984	.12
1983	.12
1982	.11
1981	.12
1980	.11
1979	.10
1978	.09
1977	.09
1976	.09
1975	.09
1974	.09
1973	.09
1972	.08
1971	.08

ITEM #12

NET INCOME AS A PERCENTAGE OF EQUITY CAPITAL

Year	Percentage
1986	13.88
1985	15.77
1984	17.28
1983	13.30
1982	14.12
1981	14.89
1980	8.02
1979	13.04
1978	17.61
1977	16.79
1976	17.60
1975	15.71
1974	17.64
1973	12.93
1972	13.03
1971	12.63

Net income is before reserve transfers.

The same definition of capital is applied here as in Item #6, Part 1.

ITEM #13

NUMBER OF EXAMINERS AND THEIR TURNOVER RATE

Year	Number Separations	Number Examiners	Turnover Rate
1986	48	407	11.7%
1985	56	358	15.6%
1984	59	367	16.0%
1983	68	363	18.7%
1982	61	338	18.0%
1981	40	340	11.7%
1980	31	330	9.3%
1979	55	337	16.5%
1978	83	339	24.4%
1977	33	308	10.7%
1976	46	311	14.7%
1975	52	316	16.4%

ITEM #14

NUMBER OF EXAMINER MANHOURS AS A PERCENTAGE OF TOTAL DEPOSITS (SHARES)

Year	Percentage
1986	6.22
1985	6.80
1984	9.06
1983	10.18
1982	11.17
1981	12.24
1980	12.54
1979	14.69
1978	15.98
1977	17.16
1976	21.31
1975	26.32

The figures represent the percentage of examiner manhours per one million dollars of deposits (shares).

ITEM #15

NUMBER AND TOTAL ASSETS OF CREDIT UNIONS WITH NEGATIVE NET WORTH

Year	Number	Assets (Millions)
1986	59	$1,452
1985	70	$1,716
1984	98	$1,275
1983	135	$1,404
1982	134	$1,250
1981	145	$293
1980	195	$176
1979	192	$158

Data not available prior to 1979.

ITEM #16

EQUITY INVESTED IN SUBSIDIARIES AS A PERCENTAGE OF TOTAL EQUITY

Year	Percentage
1986	2.40
1985	1.33
1984	1.17
1983	0.62

For the purpose of this report, equity invested in subsidiaries is defined as the amount invested in credit union service organizations (CUSOs). Information about CUSOs is not available prior to 1983. Equity is defined the same as primary capital in Item #6, Part 1.

ITEM #17

FOREIGN, FEDERAL, STATE AND LOCAL TAXES AS A PERCENTAGE OF NET INCOME

This item is not applicable to federally insured credit unions. Federal credit unions are exempt from all taxation with the exception of taxes on tangible personal property.

SUPPLEMENTAL INFORMATION

NUMBER OF MAJOR PROBLEM CASE CREDIT UNIONS

Year	Number	Cash Outstanding	Noncash Guarantees
1986	30	$22,396	$39,903
1985	45	$33,266	$36,946
1984	72	$36,413	$54,213
1983	113	$31,838	$52,736
1982	124	$16,839	$48,786
1981	114	$8,388	$42,922
1980	59	$15,447	$29,247
1979	30	$15,794	$5,791
1978	12	$13,522	$1,733
1977	9	$182	$1,080
1976	10	$115	$585
1975	5	$115	$541
1974	4	$445	—
1973	20	$308	—
1972	0	0	—
1971	0	0	—

These figures represent the number of operating credit unions with outstanding assistance from the National Credit Union Share Insurance Fund at the end of the fiscal year. These are the most severe problem cases and represent the highest degree of risk to the Insurance Fund.

SUPPLEMENTAL INFORMATION
ANNUAL GROWTH RATES FOR ASSETS AND SHARES

Year	Assets	Shares
1986	23.4%	24.2%
1985	29.0%	30.0%
1984	13.3%	13.6%
1983	17.8%	17.8%
1982	7.9%	9.0%
1981	5.8%	5.6%
1980	11.0%	14.7%
1979	6.8%	8.1%
1978	18.3%	18.2%
1977	23.8%	23.0%
1976	21.8%	21.5%
1975	26.6%	27.7%
1974	20.4%	19.8%
1973	19.5%	18.0%
1972	26.4%	27.1%

These figures are based on aggregate amounts in all federally insured credit unions and may be impacted by credit unions entering or leaving the federal share insurance system.

SUPPLEMENTAL INFORMATION

NUMBER AND TOTAL DEPOSITS (SHARES) OF PROBLEM CREDIT UNIONS AS A PERCENTAGE OF TOTAL INSURED CREDIT UNIONS

Year	Number as % of Total	Deposits as % of Total
1986	5.4	4.8
1985	4.9	3.7
1984	5.7	4.5
1983	7.1	5.8
1982	7.2	6.7
1981	6.9	5.2
1980	5.9	4.4
1979	5.8	4.8
1978	4.8	3.3
1977	4.0	1.4
1976	5.1	1.9

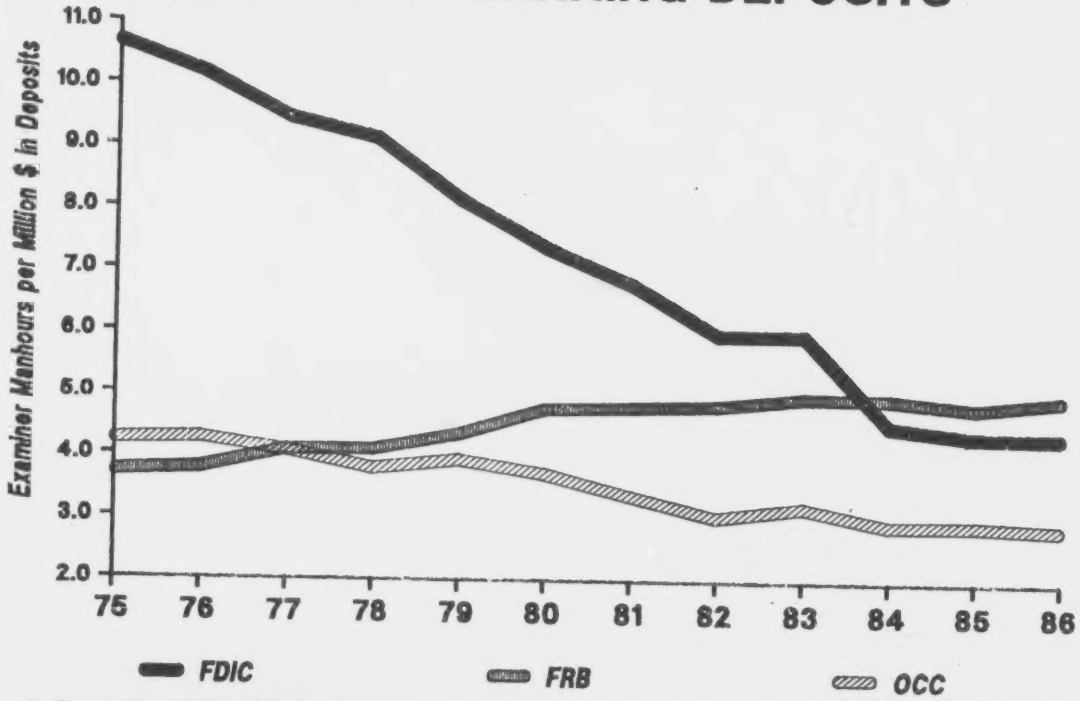
See Item #3 for definition of problem credit unions.

DEPOSITORY INSTITUTIONS
STATISTICAL INFORMATION

Prepared for the Use of
The Members of
The Senate Committee on Banking, Housing, and Urban Affairs
by the
Committee Staff
with the assistance of
Dennis M. Kane
U.S. General Accounting Office

CHART I

EXAMINER MAN–HOURS PER ONE MILLION DOLLARS IN BANKING DEPOSITS*



* *Deposits in 1986 Dollars*

CHART II

PROBLEM ORGANIZATIONS

Total Assets (A) or Total Deposits (D)

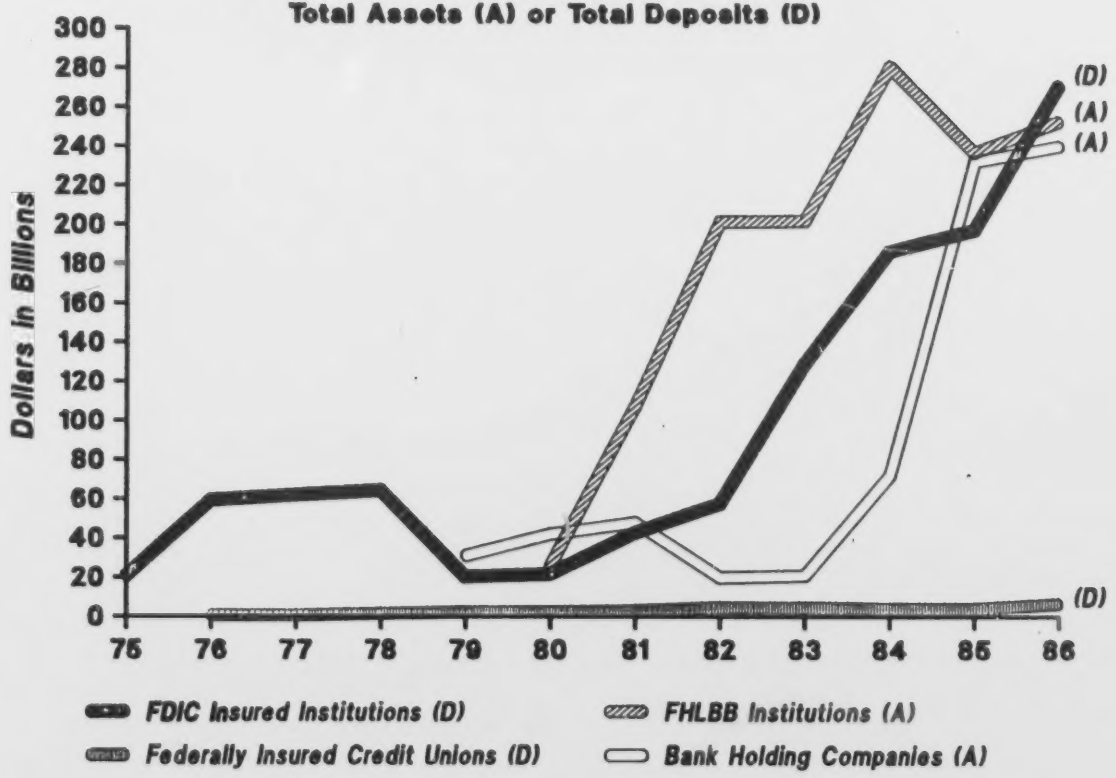


CHART III

CAPITAL RATIOS

Top 25 Insured Commercial Banks

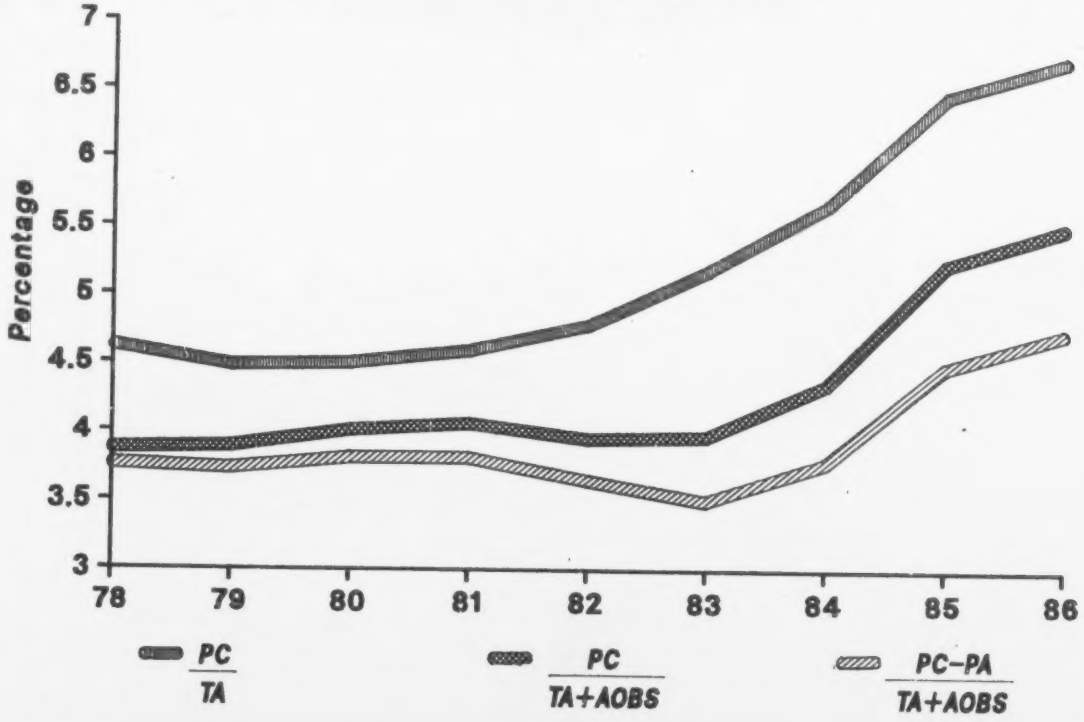


CHART IV

PROBLEM ORGANIZATIONS, NUMBER

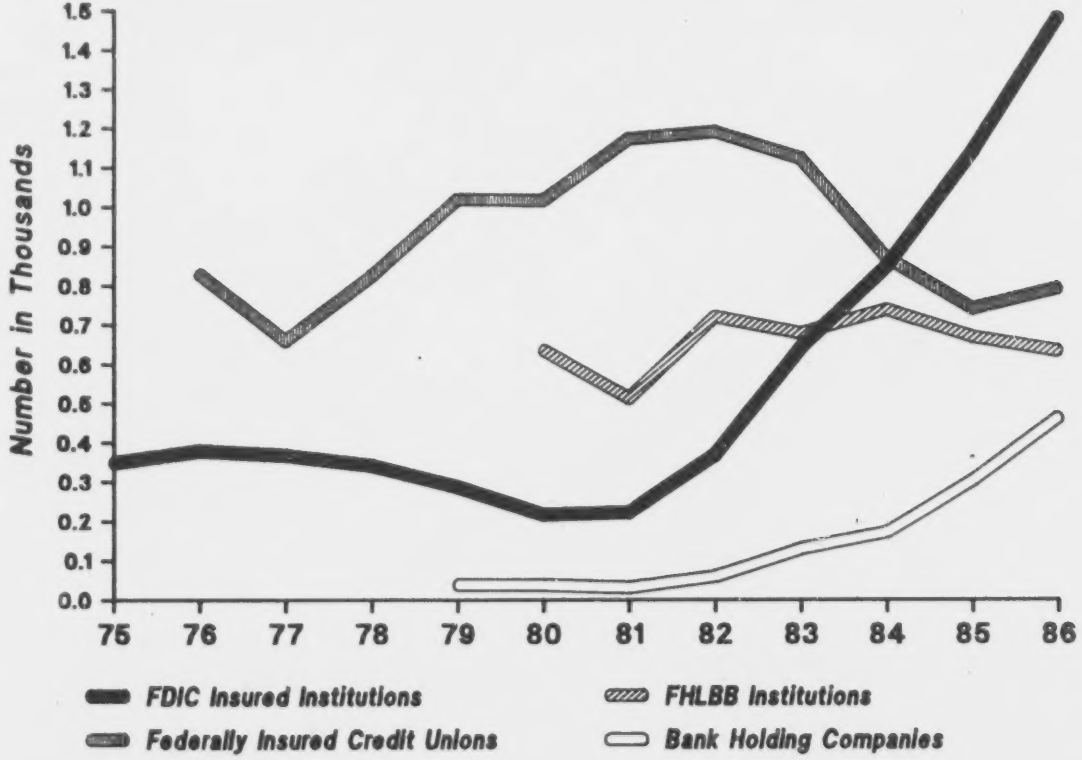


CHART V

NUMBER OF BANK EXAMINERS

1975–1985

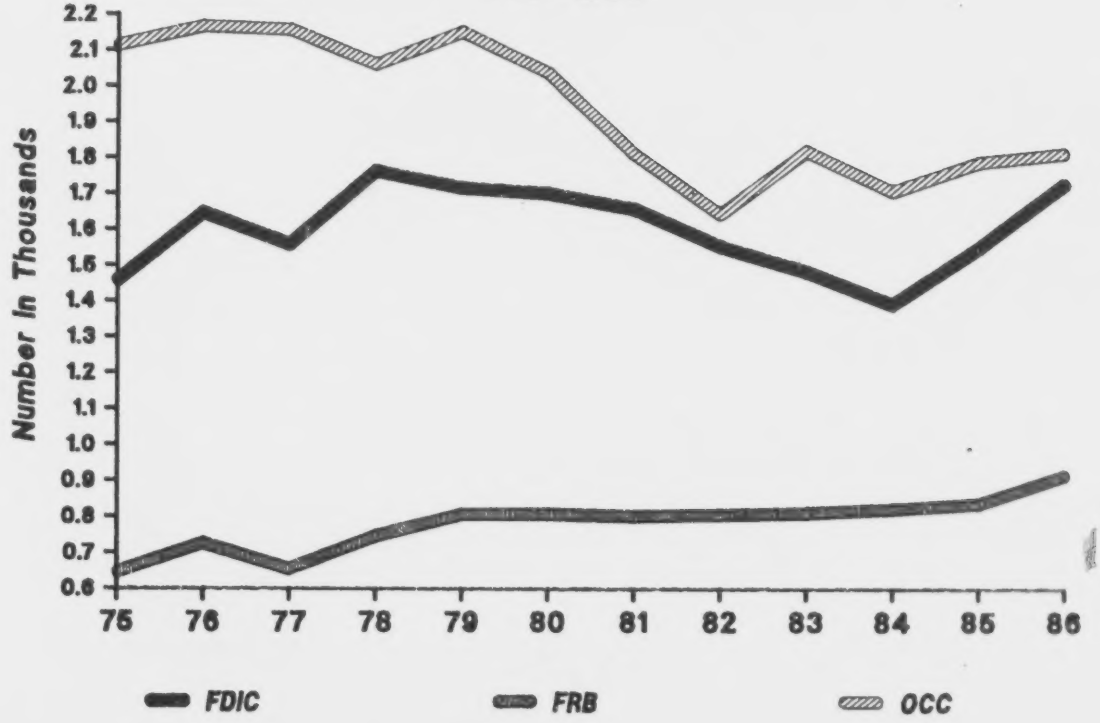


CHART VI

PRIMARY CAPITAL AS A PERCENT OF TOTAL ASSETS

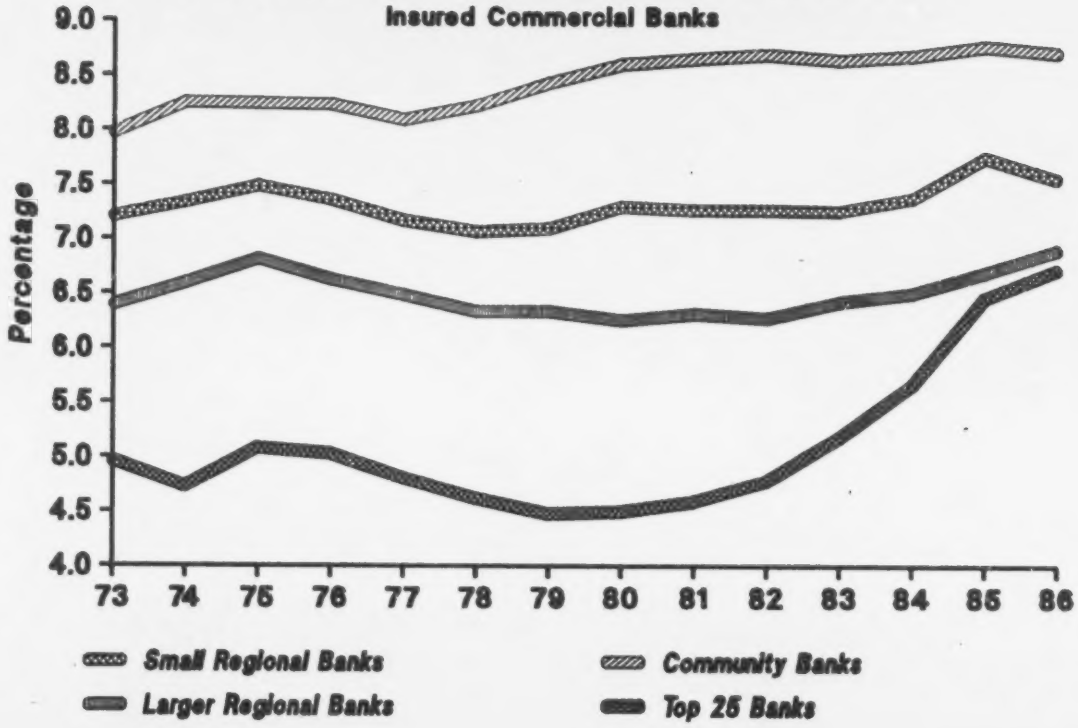


CHART VII

NET CHARGE-OFFS AS A PERCENT OF YEAR-END TOTAL ASSETS

Insured Commercial Banks

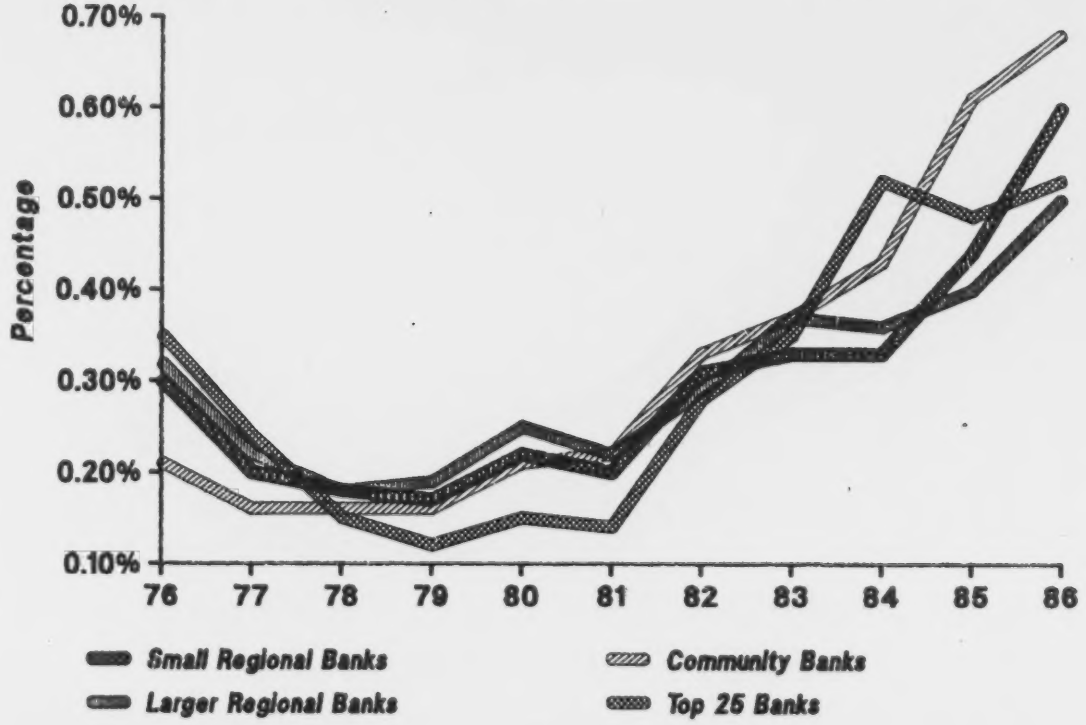


CHART VIII

NET INCOME AS A PERCENT OF TOTAL ASSETS

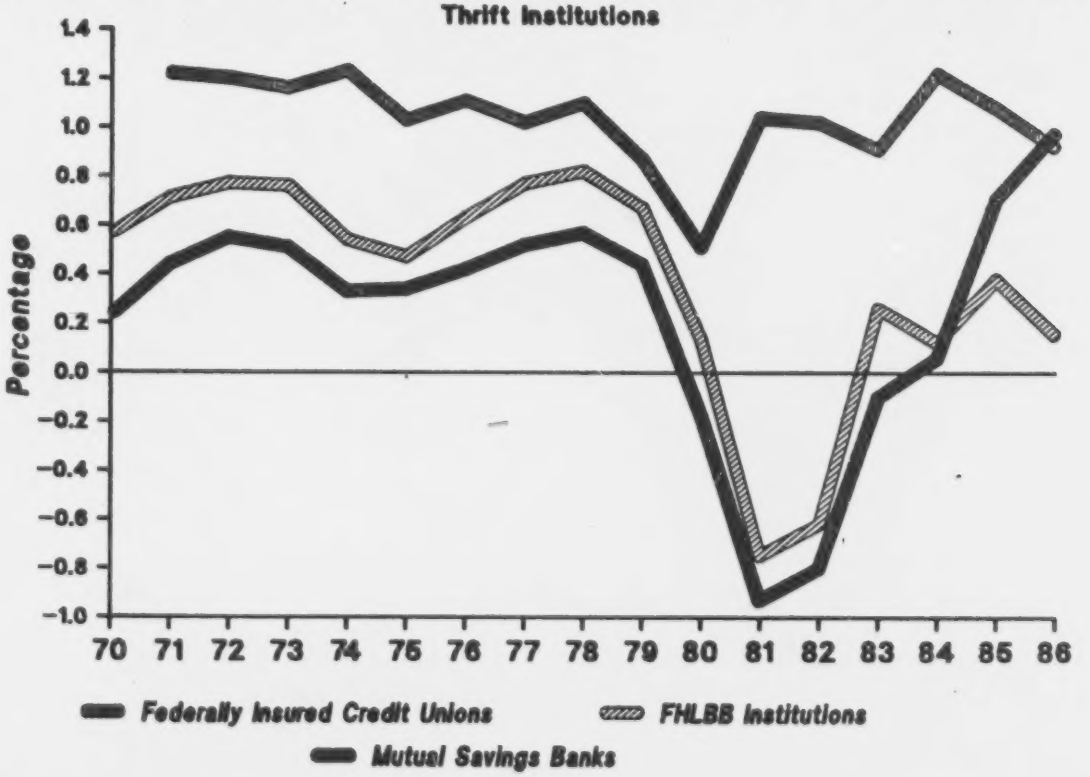


CHART IX

EQUITY & LOAN LOSS RESERVE AS A PERCENT OF TOTAL ASSETS

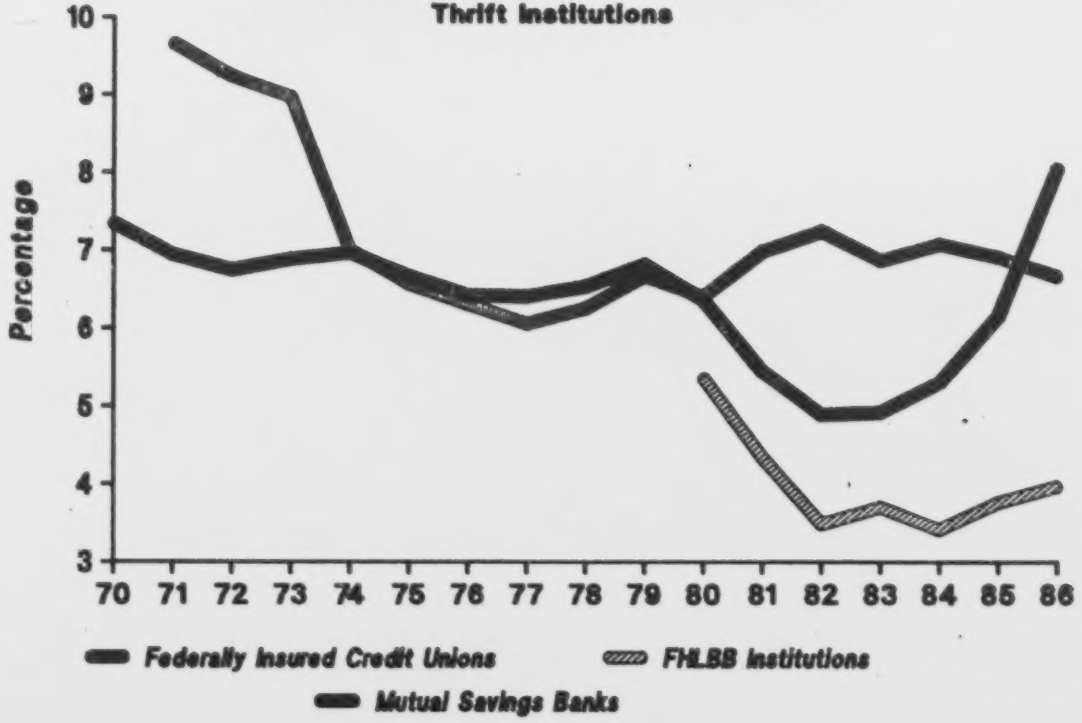
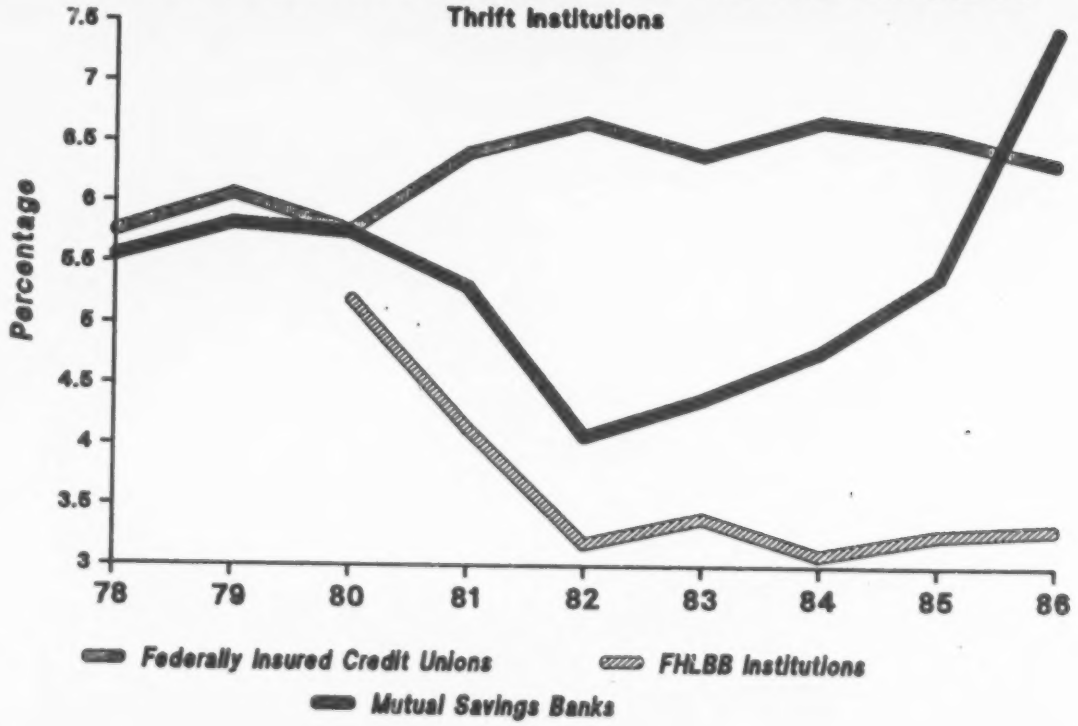


CHART X

EQUITY & LOAN LOSS RESERVE LESS CLASSIFIED ASSETS AS A PERCENT OF TOTAL ASSETS